EXHIBIT K

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002

Commission File No 0-30900

XO COMMUNICATIONS, INC.

A Delaware Corporation I R S Employer Identification No 54-1983517

11111 Sunset Hills Road, Reston, Virginia 20190
Telephone Number (703) 547-2000

Securities registered pursuant to Section 12(b) of the Act·
NONE

Securities registered pursuant to Section 12(g) of the Act
Common Stock, Par Value $0 01 Per Share

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days YES [X] NO [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Registration S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K [ ]

Indicate by check mark whether the Registrant is an accelerated filer (as defined by Rule 12b-2 of the Act) YES [X] NO [ ]

The aggregate market value of the pre-petition common stock held by non-affiliates of the Registrant, based upon the closing sale price of the common stock on June 28, 2002 (which is the last business day of the Registrant's most recently completed second fiscal quarter), as reported on the NASDAQ Over-the-Counter Bulletin Board, was approximately $7,200,000 Shares of pre-petition common stock held by each executive officer and director and by certain persons who own 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates This determination of affiliate status is not necessarily a conclusive determination for other purposes

As of March 1, 2003, the number of outstanding shares of reorganized XO Communications, Inc 's new common stock was 95,000,001

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court YES [X] NO [ ]

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e g , Part I, Part II, etc) into which the document is incorporated None

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PART I

Item 1. Business

Introduction

XO Communications, Inc , a Delaware corporation, which we refer to as XO Parent, through its predecessor entities, was formed in 1994 XO Parent was originally organized as a Washington limited partnership and in 1995 merged into a Washington limited liability company, which following several name changes became known as NEXTLINK Communications, L L C In January 1997, NEXTLINK Communications, L L C merged into NEXTLINK Communications, Inc , a Washington corporation, which in June 1998 reincorporated in Delaware under the same name On June 16, 2000, in connection with XO Parent's merger with Concentric Network Corporation, NEXTLINK Communications, Inc merged with XO Parent and XO Parent, as the surviving corporation in the merger, changed its name to NEXTLINK Communications, Inc On September 25, 2000, XO Parent began doing business as "XO Communications" and, on October 25, 2000, XO Parent changed its name to XO Communications, Inc We conduct our business primarily through the more than 50 subsidiaries that XO Parent owns and manages

On June 17, 2002, XO Parent filed for protection under Title 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York On November 15, 2002, the Bankruptcy Court confirmed XO Parent's plan of reorganization, and, on January 16, 2003, XO Parent consummated the plan of reorganization and emerged from its Chapter 11 reorganization proceedings with a significantly restructured balance sheet

In December 2001, XO Parent voluntarily delisted its pre-petition class A common stock from the Nasdaq National Market, which was traded under the symbol "XOXO", and, on December 17, 2001, began trading on the Nasdaq Over-the-Counter Bulletin Board, or OTCBB XO Parent's pre-petition class A common stock stopped trading on the OTCBB as of January 16, 2003, the effective date of XO Parent's plan of reorganization, at which time all interests in XO Parent's pre-petition class A common stock were terminated pursuant to the plan of reorganization The new common stock of reorganized XO Parent issued pursuant to its plan of reorganization began trading on the OTCBB under the symbol "XOCM" shortly after the first distribution of common stock pursuant to the plan

Our principal executive and administrative offices are located at 11111 Sunset Hills Road, Reston, Virginia 20190 and our telephone number is (703) 547-2000 Our Internet address is www xo com, where, under "About XO-Investor Center", you can find copies of this annual report on Form 10-K, and XO Parent's quarterly reports on Form 10-Q and current reports on Form 8-K, all of which we make available as soon as reasonably practicable after the report is filed with the Securities and Exchange Commission, or SEC

Overview of Our Company

We provide business customers with a comprehensive array of communications services, which include voice, Internet access, private data networking and hosting services Our services are designed to take advantage of our network assets , which are capable of carrying high volumes of all types of communications traffic, and to meet the needs of all sizes of business customers, from small and medium businesses to large enterprise and carrier and wholesale customers Although these services are of significant benefit to businesses of all sizes, we believe them to be of particular benefit to multi-location businesses that desire to improve communications among their locations, whether within a single metropolitan area or across the country These services include the following:

- Voice services
    - Local and long distance services, both bundled and stand-alone, other voice-related services such as conferencing, domestic and international toll free services and voicemail, and transaction processing services for prepaid calling cards, and
    - Interactive voice response, or IVR, systems that we develop, host and manage that enable our customers' end-users to order products and services, collect and receive information, seek assistance, facilitate bill payment and a host of other capabilities over the telephone using natural language speech recognition and systems that enable persons to access web-based information over the telephone,
- Internet access

- Dedicated Internet access for customers with large, high-speed Internet access requirements,
- Digital subscriber line, or DSL, services for businesses that require high-speed Internet access over existing copper wire telephone lines, and
- Dial access, which allows remote users to connect to a customer's network,

- Private data networking·
  - Dedicated transmission capacity on our networks, including dedicated circuits and the lease of one or more dedicated wavelengths on a fiber optic cable, to customers that desire high-bandwidth links between locations,
  - Virtual private network, or VPN, services, which provide customers with a managed, private data service over the public Internet, designed for medium and large businesses that want to create secure, wide-area networks for users at various and remote locations, and
  - Ethernet services, which are designed to connect the local area networks, or LANs, of medium and large customers within and between metropolitan areas at speeds of up to one gigabit per second, and

- Hosting services
  - Web site services, which allow a customer to establish a Web presence,
  - Web hosting, including hosting and web site traffic management tools, for Internet-centric businesses, and streamed media services designed for small and medium-sized businesses, and
  - Server collocation and management and customer support to manage a customer's hosting needs

We also combine many of these services in integrated, flat rate service packages, known as XOptions that are tailored to the communications needs of small and medium-sized businesses and larger businesses with multiple locations These packages eliminate the separation between local and long-distance communications services, and combine this "all distance" telephone service with high-speed Internet access and web hosting services, all for one flat monthly rate We also offer shared tenant services, which consist of telecommunications management services provided to groups of small and medium-sized businesses located in the same office building

We believe that one of the significant factors used by business customers in making purchase decisions relating to communications services is the quality of service and customer support offered by the service provider Our customer care representatives offer customer support 24 hours a day, seven days a week We focus on proactive resolution of customer issues by training our customer care representatives extensively on the services that we offer and promoting accountability of the customer care team We also have developed a secure, on-line Business Center, through which many customers can access information about their accounts and track requests, review services, analyze trends, make decisions and pay bills

To serve our customers' broad and expanding telecommunications needs, we operate a network comprised of a series of rings of fiber optic cables located in the central business districts of numerous metropolitan areas, which we refer to as metro fiber networks, that are connected primarily by a network of numerous dedicated wavelengths of transmission capacity on fiber optic cables, which we refer to as an inter-city network By integrating these networks with advanced communications technologies, we are able to provide a comprehensive array of communications services primarily or entirely over a network that we own or control, from the initiation of the voice or data transmission to the point of termination, which we refer to as end-to-end service This capability enables us to provide communication services between customers connected to our network, and among a customer's multiple locations, primarily or entirely over our network

To develop these networks, we have assembled a collection of metro and inter-city network assets in the United States, substantially all of which we own or control, making us a facilities-based carrier These network assets incorporate state-of-the-art fiber optic cable, dedicated wavelengths of transmission capacity on fiber optic networks and transmission equipment (including switches and routers that direct voice and data traffic to their destinations) capable of carrying high volumes of data, voice, video and Internet traffic. We operate 37 metro fiber networks in 22 states and the District of Columbia, including 25 of the 30 largest metropolitan areas in the U S We have constructed or acquired many of these metro fiber networks, which consist of up to 432 strands of fiber optic cable and, in some cases, additional empty conduits through which fiber optic cable can be deployed For our inter-city

network, we have acquired dedicated, high-capacity wavelengths of transmission capacity on fiber optic cables, onto which we have deployed our own switching, routing and optical equipment, thereby giving us greater control over the transmission of voice and data information We also hold indefeasible exclusive rights to use unlit fiber optic strands on the routes served by our existing inter-city network

Our Chapter 11 Reorganization

On June 17, 2002, XO Parent filed for protection under the Bankruptcy Code On November 15, 2002, the Bankruptcy Court confirmed XO Parent's plan of reorganization, and, on January 16, 2003, XO Parent consummated the plan of reorganization and emerged from its Chapter 11 reorganization proceedings with a significantly restructured balance sheet

Events Leading Up to the Chapter 11 Reorganization

From 1996 through 2001, we financed the construction and acquisition of our networks, our growth and our working capital requirements through public and private offerings of senior and subordinated unsecured notes and common and preferred equity securities In addition, in 2000, we financed certain network acquisitions and some of our working capital requirements through secured borrowings under XO Parent's $1 0 billion senior secured credit facility, which we refer to as the Pre-Petition Credit Facility As of December 31, 2001, we had approximately $5 2 billion in secured and unsecured long term debt obligations and approximately $1 8 billion in liquidation preference of preferred stock

In 2001, market valuations of debt and equity securities of telecommunications companies, especially emerging providers such as us, experienced significant declines, leading to a wave of bankruptcies in the industry As a result, the capital markets were largely closed to emerging telecommunications companies which made it difficult or impossible for companies like us to obtain additional funding In response to these conditions, we implemented stringent measures in 2001 that were designed to conserve cash and reduce operating expenses and capital expenditures Despite these efforts, we concluded that our cash on hand would not be sufficient to fund operations, capital expenditures and debt service until such time as we expected our operations to become profitable and we determined that a restructuring of our balance sheet was necessary

The Chapter 11 Petition and Plan of Reorganization

During the period preceding and immediately after the filing of XO Parent's Chapter 11 petition, we met with a committee of lenders under the Pre-Petition Credit Facility, an informal committee of unsecured creditors that represented holders of our unsecured notes (and following the filing of the Chapter 11 petition, the official committee of unsecured creditors appointed in the Chapter 11 proceedings) and potential investors to discuss potential transactions that could be implemented to reorganize our capital structure These discussions led to an agreement with certain of our creditors regarding the terms of a plan of reorganization that envisioned two reorganization structures, the first of which was based on, among other things, a proposed cash investment in XO Parent by third parties (which was ultimately abandoned), and the second of which contemplated a stand-alone restructuring with no new cash infusion committed in advance The plan of reorganization, as supplemented, was filed with the Bankruptcy Court on July 22, 2002 and distributed to creditors of XO Parent eligible to vote in the reorganization We refer to the stand-alone alternative under the plan of reorganization that ultimately was confirmed by the Bankruptcy Court as the Plan of Reorganization

On August 21, 2002, High River Limited Partnership, a limited partnership controlled by Mr Carl Icahn, commenced an offer to purchase loans under the Pre-Petition Credit Facility at a purchase price of $0 50 for each $1 00 in principal amount thereof Purchases made under this offer, together with the loans under the Pre-Petition Credit Facility that High River previously had acquired, resulted in High River holding approximately 85% of the loans outstanding under the Pre-Petition Credit Facility

On November 15, 2002, the Bankruptcy Court confirmed the Plan of Reorganization On January 16, 2003, XO Parent consummated the Plan of Reorganization and emerged from its Chapter 11 reorganization proceedings

Distributions Under the Plan of Reorganization

After the consummation of the Plan of Reorganization, and giving effect to the implementation of fresh start accounting, our capital structure consists of the following

- $500 0 million in outstanding principal amount of loans under a restructured secured credit and guaranty agreement, which we refer to as the New Credit Agreement,
- $80 2 million of other long-term liabilities, which include various capital lease obligations, and
- 95 0 million outstanding shares of common stock, par value $0 01 per share, which we refer to as New Common Stock

We are not required to pay cash interest accrued on the principal amount under the New Credit Agreement until we meet certain financial ratios

The consummation of the Plan of Reorganization resulted in the $1 0 billion of loans under the Pre-Petition Credit Facility being converted into the following

- 90 25 million shares of New Common Stock, and
- $500 0 million of outstanding principal amount of loans under the New Credit Agreement

The Plan of Reorganization also resulted in the cancellation of all of XO Parent's pre-petition senior unsecured notes and general unsecured claims in exchange for the following

- 4 75 million shares of New Common Stock,
- warrants to purchase up to an additional 23 75 million shares of New Common Stock,
- rights to purchase shares of New Common Stock at $5 00 per share in the rights offering described below, and
- a portion of the cash consideration received by XO Parent in connection with the settlement and termination of the proposed investment transaction that was the basis for the first restructuring alternative contemplated by the Plan of Reorganization, which we refer to as the Investment Termination Payment

The warrants consist of

- Series A Warrants to purchase 9 5 million shares of New Common Stock at an exercise price of $6 25 per share,
- Series B Warrants to purchase approximately 7 1 million shares of New Common Stock at an exercise price of $7 50 per share, and
- Series C Warrants to purchase approximately 7 1 million shares of New Common Stock at an exercise price of $10 00 per share

The warrants will expire 7 years after the date of issuance Each series of warrants is identical, except as to the applicable exercise price The exercise price applicable to each respective series of warrants is subject to adjustment in certain events

Under the Plan of Reorganization and after the SEC has declared effective our registration statement, XO Parent will issue to certain holders of claims and interests in XO Parent who held such claims and/or interests as of the November 15, 2002 record date for distributions under the Plan of Reorganization, rights to subscribe for up to 40,000,000 shares of New Common Stock, at $5 00 per share, for an aggregate purchase price of up to $200 0 million, through a rights offering, which we refer to as the Rights Offering In addition, pursuant to the stipulation relating to the settlement of claims made against XO Parent purportedly on behalf of its stockholders, which we refer to as the Stockholder Stipulation, holders of shares of pre-petition class A common stock of XO Parent will receive addit ional nontransferable rights to the extent that the rights otherwise allocable to such holders in the Rights Offering are exercisable for less than 3,333,333 shares of New Common Stock Accordingly, no less than 40,000,000 and not more than 43,333,333 shares will be offered in the Rights Offering

Pursuant to the order confirming our Plan of Reorganization, the Rights Offering will not take place until the date a registration statement covering the offer and sale of such rights and shares to be offered thereunder shall have been filed with the SEC and such registration statement shall have become effective. **We have not yet filed a registration statement with respect to the rights and the Rights Offering will not commence until after the registration statement has been filed with and declared effective by the SEC.**

In addition, under the Plan of Reorganization

- Holders of pre-petition subordinated notes of XO Parent had their securities cancelled, and received a cash payment from High River based upon the amount of the Investment Termination Payment that High River would have been entitled to receive as holder of the loans under the New Credit Agreement and the right to participate in the Rights Offering,
- Holders of pre-petition class A common stock of XO Parent had their securities cancelled, and received the right to a portion of the cash consideration pursuant to the Stockholder Stipulation and have the right to participate in the Rights Offering, and
- Holders of pre-petition class B common stock and holders of all series of pre-petition preferred stock of XO Parent had their securities cancelled and received only the right to participate in the Rights Offering

Post-Bankruptcy Interests Held by Entities Controlled by Carl Icahn

Of the 90 25 million shares of New Common Stock distributed to the lenders under the Pre-Petition Credit Facility, approximately 76 6 million shares were issued to High River upon consummation of the stand-alone restructuring under the Plan of Reorganization Immediately following this distribution, High River transferred all shares of New Common Stock to Cardiff Holding LLC, a Delaware limited liability company controlled by Mr Icahn

Meadow Walk Limited Partnership, a limited partnership controlled by Mr Icahn, owned over $1 5 billion in principal amount of various tranches of XO Parent's pre-petition senior unsecured notes, representing approximately 33% in principal amount of such notes Meadow Walk has transferred beneficial ownership to all distributions with respect to such notes under the Plan of Reorganization to Cardiff

Giving effect to these transactions and the distributions of New Common Stock pursuant to the Plan of Reorganization, Cardiff holds over 80% of the outstanding shares of the New Common Stock

Of the warrants to be distributed under the Plan of Reorganization to holders of the pre-petition senior unsecured notes, Cardiff estimates it will receive Series A Warrants to purchase approximately 3 0 million shares of New Common Stock, Series B Warrants to purchase approximately 2 3 million shares of New Common Stock, and Series C Warrants to purchase approximately 2 3 million shares of New Common Stock As of the date hereof, XO has not made any distribution of warrants to any holder of old senior unsecured notes or general unsecured creditor of XO Parent

In connection with the Plan of Reorganization, High River received approximately 85% of the loans outstanding under the New Credit Agreement In January 2003, High River assigned all of its rights in the loans outstanding under the New Credit Agreement to Chelonian Corp , a corporation owned and controlled by Mr Icahn Subsequently, these loans were assigned to Arnos Corp , a corporation owned and controlled by Mr Icahn As a result, Arnos now holds approximately 85% of the loans outstanding under the New Credit Agreement

Accounting for Consummation of Plan of Reorganization

As a result of the consummation of the Plan of Reorganization, we have determined that XO Parent is required to implement the "fresh start" accounting provisions of AICPA Statement of Position 90-7, "Financial Reporting by Entities in Reorganization Under the Bankruptcy Code," which we refer to as SOP 90-7, to its financial statements The fresh start accounting provisions require that we establish a "fair value" basis for the carrying value of the assets and liabilities for reorganized XO, the implementation of which will result in a substantial reduction in the carrying value of our long-lived assets, including property and equipment, fixed wireless licenses, other intangible assets and other noncurrent assets As discussed in note 3 to our audited consolidated financial statements set forth in Item 8 below, the consolidated balance sheets to such financial statements include pro forma information as if the fresh start accounting provisions of SOP 90-7 had been implemented as of December 31, 2002

Under SOP 90-7, the implementation of fresh start reporting is triggered in part by the emergence of XO Parent from its Chapter 11 proceedings Although the effective date of the Plan of Reorganization was January 16, 2003, we plan to account for the consummation of the Plan of Reorganization as if it had occurred on January 1, 2003 and implement fresh start reporting as of that date

For further discussion of the effects of the transactions contemplated by the Plan of Reorganization on our financial condition and results of operations, see "Our Chapter 11 Reorganization" and "Liquidity and Capital Resources" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations "

2002 Capital Conservation Initiatives

During 2002, in conjunction with the actions taken in connection with our Chapter 11 reorganization, we took a number of steps in an effort to conserve our available funding, including some modest workforce reductions in addition to those initiated in 2001, and to reduce our long-term obligations

Amendment to Level 3 Inter-city Network Agreement In August 2002, we entered into a Master Agreement with Level 3 Communications, Inc , which amends various agreements related to our acquisition of fiber networks in the United States from Level 3 and the recurring maintenance charges relating to those networks Beginning on January 1, 2003 and continuing over the remaining term of the initial agreement, Level 3 has reduced the operating and maintenance fees as well as fiber relocation charges from approximately $17 0 million annually to a fixed rate of $5 0 million annually In exchange for this reduction and certain other concessions, we surrendered our indefeasible right to use an empty conduit and our indefeasible right to use six of the 24 fibers previously acquired from Level 3

Sale of European Business In February 2002, we completed the sale of the European Internet service provider business that we acquired as part of the 2000 acquisition of Concentric Network Corporation

Applications and Services

We provide business customers with a comprehensive array of data and voice communications services, which include voice, Internet access, private data networking and hosting services We have designed these communications services to meet the needs of all sizes of business customers, from small and medium businesses to multi-location businesses, and large enterprise, and carrier and wholesale customers

Voice Applications and Services

Local and Long Distance Voice Services

We offer a variety of voice applications and services, generally to businesses at prices significantly lower than for comparable local services from the incumbent carrier These voice services include

- local standard dial tone, including touch-tone dialing, 911 access and operator assisted calling,
- local multi-trunk dial tone services, including direct inward dialing, and direct outward dialing,
- long distance services, including 1+, toll free, calling card and operator services,
- voice messaging with personalized greetings, send, transfer, reply and remote retrieval capabilities;
- conferencing services, including voice and web conferencing services, and
- directory listings and assistance

In each of our markets, we have negotiated and entered into interconnection agreements with the incumbent carrier and certain independent carriers, and implemented permanent local number portability, which allows customers to retain their telephone numbers when changing telephone service providers

Hosted Interactive Voice Response

We develop and manage hosted interactive voice response, or IVR, systems for customers that enable end users to order products and services, collect and receive information, seek assistance, facilitate bill payments, and a host of other capabilities over the telephone Our hosted IVR capabilities utilize a wide range of technologies, from standard touch-tone / push-button dialing to natural language speech recognition and extensible markup language, or XML, and VoiceXML technologies, which are sophisticated systems that enable persons to access Web-based information over the telephone We customize for our clients' particular needs telephony-based software applications and technologies developed by third parties to create IVR systems We integrate these IVR systems with our clients' other business systems, such as information databases and customer relationship management systems We host and maintain the IVR systems in data centers and deploy them to clients across a network, thereby alleviating the need for our clients to purchase, own, install, or maintain these applications Clients pay for the use of these customized

solutions through a combination of "upfront" payments for development and recurring fees based on transaction volume We also host and manage personal-identification number, or PIN, management systems, primarily pre-paid calling card systems for customers, which includes providing transaction processing services relating to prepaid calling card services provided by other telecommunications carriers

Data Applications and Services

Internet Access

Our Internet access offerings include dedicated access services targeted at businesses that desire single or multipoint high-speed, dedicated connections to the Internet, at speeds ranging from 56 kilobits per second, or kbps, to 155 megabits per second, or mbps, and digital subscriber line, or DSL, services that include a wide range of dedicated access speeds We are a tier-1 Internet backbone provider in the U S , with over 200 public and private peering arrangements with other Internet backbones

Private Data Networking

We provide dedicated transmission capacity on our networks to customers that desire high-bandwidth links between locations We offer special access and point-to-point circuits to long distance carriers and other high volume customers, which are used as both primary and back-up circuits In addition, fiber optic technology that enables signals to be transmitted at different wavelengths on a single fiber allows us to lease one or more dedicated wavelengths to customers that desire high-bandwidth links between locations We currently offer these services with connections of up to 9 6 gigabits per second, or what our industry refers to as OC-192 This service supports a variety of transmission protocols, including ATM, Frame Relay and SONET

Our virtual private network, or VPN, services enable customers to deploy tailored, Internet Protocol-based mission-critical business applications for secure internal enterprise, business-to-business and business-to-customer data communications among geographically dispersed locations, while also affording high-speed access to the Internet VPN services also provide secure access for remo te users, such as traveling employees and employees working from home or a remote location, which is not possible using private line and frame relay services We also offer managed firewall services

Finally, we offer a suite of Ethernet services, including Gigabit Ethernet, or GigE, in most of our U S markets, as well as inter-city Ethernet services between our markets Our Ethernet services are designed to provide high-speed, high-capacity connections between customers' local area networks, or LANs, within and between metropolitan areas, while eliminating the need for ongoing configuration, management and acquisition of equipment by the customer These services are designed to provide private networking data speeds ranging from 10 or 100 megabits per second to one gigabit per second connections, to simplify customers' network connections, and to significantly reduce their costs

Hosting Services

We offer a range of applications hosting services, which can manage a customer's web-based infrastructure and operational needs allowing customers to focus on their web-based content In addition, we provide server management tools and services to manage customers' larger computers (which are known as servers) for them

To provide this service, we have equipped our data centers and have configured the central offices of our network backbone with electrical and environmental controls and 24-hour maintenance and technical support, to provide an attractive location for our customers to locate their servers or from which they can run important applications on servers that we maintain

Our hosting services include

- **Web Hosting:** support for customers' websites, including design, maintenance and telecommunications services;
- **Server Collocation:** collocation of customers' servers in our data centers, and
- **Application Hosting:** running our customers' enterprise-wide applications at our data centers and distributing them as needed over our network or servers to ensure uniformity, reduce costs and implement upgrades on a continuous and immediate basis

As part of some of our XOptions integrated packages of communications services, we offer web hosting with Microsoft's bCentral web-based tools and applications, which enables customers to conduct targeted email marketing, register their web site with hundreds of Internet search engines and directories, build catalogues and sell products over the web, and coordinate meetings and appointments online We also offer a suite of hosting outsourcing services that provide customers web-based access to email, group distribution lists, calendaring, contacts databases management and file sharing Hosting can be "shared", in which we own the equipment and provide the underlying services, or "dedicated," in which we provide some or all of the hosting and services from our data centers using the customer's own equipment

Integrated Voice and Data Services

We offer bundled packages of voice and data products, known as XOptions, to small and medium-sized businesses, that include integrated, flat-rate packages for specified amounts of certain services, including local and long distance voice services, Internet access and web hosting services These services include a variety of service packages designed to accommodate different sized customers with anywhere from 10 to 100 employees per location XOptions eliminates the complexity of working with multiple service providers for installation, maintenance and billing, and also can result in significant savings over the average cost of buying these services from separate competitive voice and data providers We also offer Integrated Access Services, which can reduce telecom costs by combining local voice long distance, and dedicated Internet access on a single facility

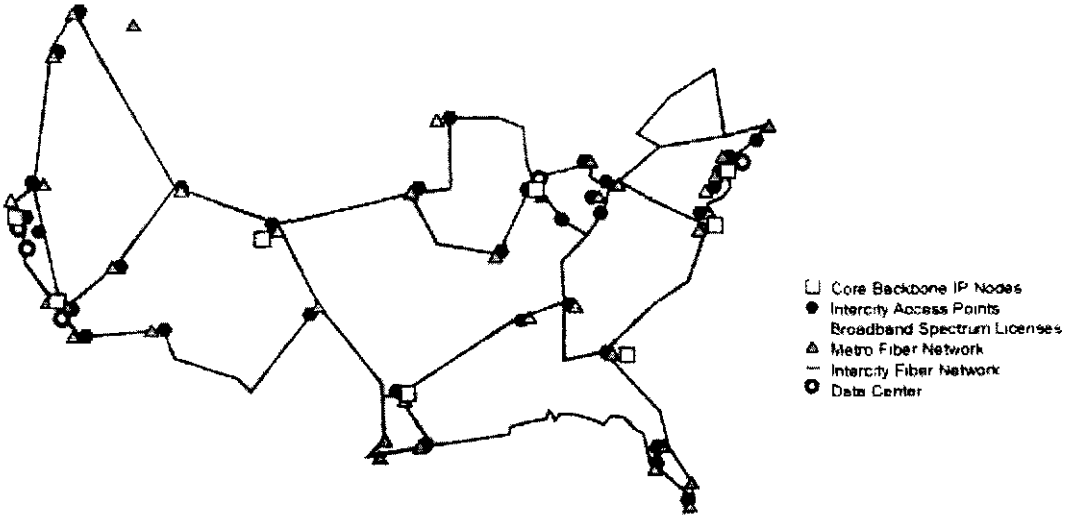
In 2002, we introduced a number of new XOptions packages designed to meet the needs of larger customers, specifically, those with small offices at multiple locations, those desiring to pool hosting and email accounts across multiple locations under a single account, and those that rely heavily on voice communications services We also introduced XOptions packages that combine the benefits of XOptions' local and long distance voice, Internet access and web hosting with Microsoft's bCentral web-based tools and applications

Our integrated services also include shared tenant services, which are telecommunications management services provided to groups of small and medium-sized businesses located in the same office building This service enables businesses too small to justify hiring their own telecommunications managers to benefit from the efficiencies, including volume discounts, normally available only to larger enterprises We install an advanced telecommunications system throughout each building we serve, leasing space for on-site sales and service, and offer tenants products and services such as telephones, voice mail, local calling lines, discounted long distance and high-speed Internet connections, all on a single, detailed invoice

XO's Networks

We have built fiber optic networks with robust capacity in urban centers in North America Our IP-optimized inter-city network in North America connects these local networks to one another

The following diagram depicts the physical components of our nationwide networks



Metro Fiber Optic Networks

The core of each of our metro fiber networks is a ring of fiber optic cable in a city's central business district that connects to our central offices These central offices contain the switches and routers that direct data and voice traffic to their destinations, and also have the space to house the additional equipment necessary for future telecommunications services Whenever we can, we build and own these metro fiber networks ourselves or obtain indefeasible rights to use fiber so that we can control the design and technology used to best meet our customers' needs We operate 37 metro fiber networks serving the cities noted below

State	Market	State	Market
Arizona	Phoenix	Missouri	St Louis
California	Los Angeles	Nevada	Las Vegas
	Orange County Anaheim, Costa Mesa, Fullerton, Garden Grove, Huntington Beach, Inglewood, Irvine, Long Beach, Orange, and Santa Ana	New Jersey	Bergen/Passaic
			Middlesex
			Newark
		New York	Manhattan
		Ohio	Cleveland
	Sacramento		Columbus
	San Diego		Akron
	San Francisco Bay Area		Canton
	Fremont, Milpitas, Mountain View, Oakland, Palo Alto, San Jose, San Francisco, Santa Clara and Sunnyvale	Oregon	Portland
		Pennsylvania	Central Pennsylvania Allentown, Harrisburg, Lancaster, and Reading
Colorado	Denver		Philadelphia
Delaware	Wilmington		Scranton/Wilkes Barre
District of Columbia	Washington		
Florida	Miami	Tennessee	Memphis
	Fort Lauderdale		Nashville
	Orlando		
	Tampa Bay		
Georgia	Atlanta	Texas	Austin
	Marietta		Dallas
Illinois	Chicago		Houston
			San Antonio
Maryland	Baltimore	Utah	Salt Lake City
Massachusetts	Boston		Orem/Provo
Michigan	Detroit	Washington	Seattle
Minnesota	Greater Minneapolis/St Paul		Spokane
			Vancouver

We built our high capacity metro fiber networks using a backbone density typically ranging between 72 and 432 strands of fiber optic cable Fiber optic cables have the capacity, or bandwidth, to carry tens of thousands of times the amount of traffic as traditionally-configured copper wire We believe that installing high-count fiber strands will allow us to offer a higher volume of broadband and voice services without incurring significant additional construction costs To enhance our ability to economically connect customers to our networks and services, we design our networks to serve both core downtown areas and other metropolitan and suburban areas where business development supports the capital required for the network build

Inter-City Network

We have created a single, end-to-end network by linking our metro fiber networks to one another through the use of an inter-city fiber optic network, largely purchased from Level 3, which enables us to offer our customers integrated, end-to-end communications services over facilities we control All of our metro networks are connected to this inter-city network, either directly or through other connections

Although we own rights to multiple fibers primarily on the Level 3 network, to conserve capital, we have delayed "lighting" much of our inter-city fibers and provide inter-city transport primarily by purchasing wavelength capacity from Level 3 along the same routes as our inter-city network assets onto which we have deployed transmission and routing equipment By using our own transmission and routing equipment, we maximize the capacity and enhance the performance of the network as needed to meet our customers' current and future broadband data and other communications needs, rather than relying on the owners of leased lines to make those upgrades

Using Level 3 wavelength services and our own routers and transport equipment, we also operate an OC-192 capacity Internet backbone, onto which a substantial amount of our Internet-related services and customer traffic runs This backbone provides our customers with improved network redundancy, security and performance, and enables us to offer customers services that take advantage of future Internet Protocol technologies

Our inter-city network assets primarily consist of an exclusive interest in 18 unlit fibers in a shared, filled conduit in the Level 3 North American network, which consists of a fiber network that traverses over 16,000 miles

and connects more than 60 cities in the United States and Canada, including most of the major metropolitan markets served by our metro networks We will install optical network equipment to "light" specific segments of this inter-city fiber where the demand for telecommunications capacity makes the related capital expenditures economic in comparison to purchasing wavelength or other capacity Due to the need for additional, cost-efficient capacity along the segment of this network that runs from Los Angeles to San Diego, we are in the processes of lighting this network segment, which is the only segment that we have current plans to light Much of the equipment used in connection with our inter-city network is positioned so that we can easily transfer voice and data traffic from the wavelength capacity purchased from Level 3 to servers on our inter-city fiber network as portions of that network are lit

Connecting Customers to Our Networks

We attempt to connect our customers directly to our networks where it is economical to do so We believe that by deploying direct connections to our customers, rather than connecting through the incumbent carriers' facilities, we will reduce our costs and be better positioned to meet our customers' communications requirements and to more rapidly deploy our service We connect customers to our networks by using fiber optic cable and, in limited circumstances, fixed wireless spectrum,

In many cases, we must lease facilities from an incumbent carrier to connect a customer to our network By building our metro networks in central business districts, in many cases we have minimized the distance from our network to a potential customer, which results in lower costs associated with these leased facilities because the cost of those facilities is generally based, in part, on the length of the leased connection

Fiber Optics In cases where expected revenues justify the construction cost, we will install a new fiber optic extension from our network to the customer's premises Whether it is economical to construct a fiber optic extension depends, among other things, on

- the existing and potential revenue base located in the building in question,
- the building location relative to our network and our ability to access the communications equipment in that building, and
- local permit requirements

Even if we initially determine that it is not economical to construct a fiber connection to a building, we will continually reexamine the costs and benefits of a fiber connection and may at a later date determine that construction of one is justified

Broadband Wireless Spectrum In cases where construction of a fiber optic connection is not practical or economical, in limited cases we have deployed a high-bandwidth wireless connection between an antenna on the roof of the customer's premises and an antenna attached to our fiber rings We hold licenses to fixed wireless spectrum in numerous cities, covering areas where 95% of the population of the 30 largest U S cities live or work

In those limited cases where we decide to install equipment to operate fixed broadband licenses, we must secure roof and other building access rights, including access to conduits and wiring from the owners of each building or other structure on which we propose to install our equipment, and may need to obtain construction, zoning, franchise or other governmental permits

DSL Technology We have also deployed DSL technology to meet the high-bandwidth needs of those customers located less than three miles from the incumbent carrier's central office and whose customer connection remains over copper wire DSL technology reduces the bottleneck in the transport of information, particularly for data services, by increasing the data carrying capacity of copper telephone lines We believe that, for many small to medium sized customers within the geographic areas that can be served by DSL technology, existing copper connections using DSL technology from customer buildings to our local fiber optic networks will offer a lower cost solution for providing high-quality broadband services than fiber or fixed wireless connections

We offer DSL service in numerous markets in the U S , mainly through wholesale arrangements with the incumbent carriers and other DSL service providers We have introduced our own DSL equipment and services at many collocation sites, including central offices of the incumbent carriers that serve a significant number of business customers

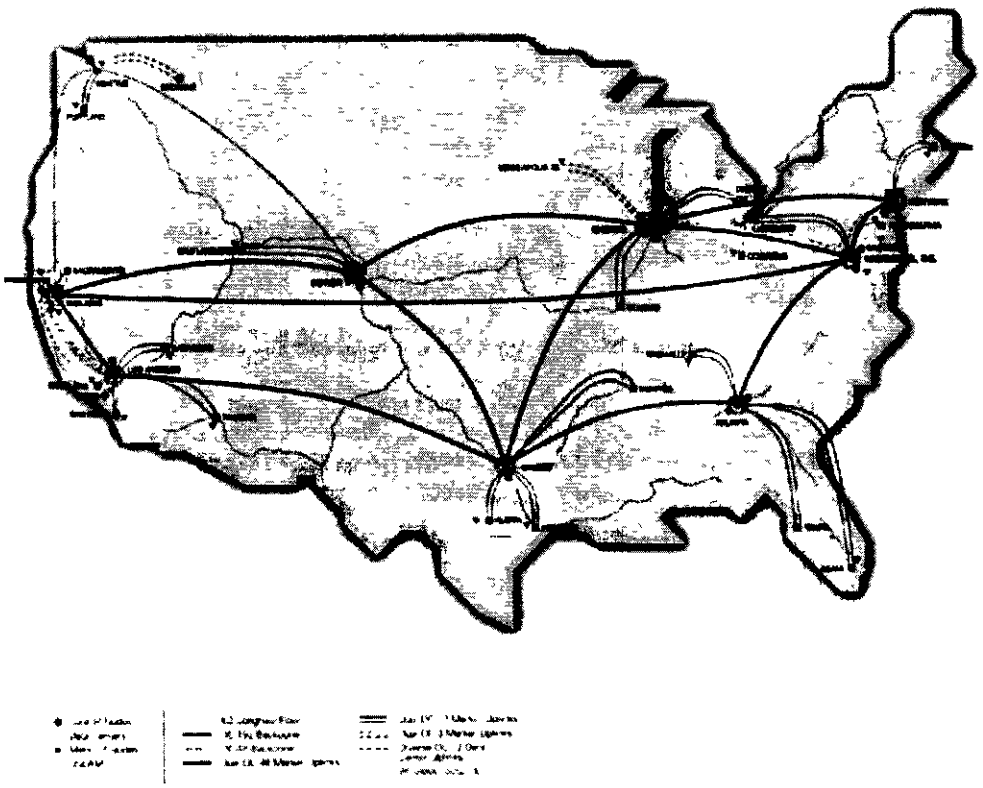
Network Technology

Overview

The wires, cables and spectrum that comprise the physical layer of our networks can support a variety of communications technologies We seek to offer customers a set of technology options that can support services that meet their changing needs and introduce new technologies as necessary Specifically, we believe that a service platform based on Internet Protocol, or IP, will provide us with significant future opportunities, because it will enable data, voice and video to be carried inexpensively over our end-to-end, facilities-based network Consequently, we have supplemented our current data and voice switching technology with IP equipment

Over the past few years, both optical and IP-based networking technologies have undergone rapid innovation These technological developments enable us to offer our customers numerous high-speed data services Many of these innovations have the effect of increasing the efficiency of the physical components of our network by increasing the effective capacity of networks for these types of applications In the future, we expect that IP-based technology will become the preferred technology for voice calls and facsimile transmission as well We plan to remain flexible in our use of technology, so that, as underlying communications technology changes, we will have the ability to take advantage of and implement new technologies that best meet our network requirements and customers' needs

The illustration below depicts the configured circuit capacities deployed in the IP network



Fiber Optic Technology

To enhance the capacity of our metro networks, we are incorporating dense wavelength division multiplexing technology, which makes it possible to simultaneously transmit data at more than one wavelength, thereby allowing the transmission of multiple signals through the same fiber at different wavelengths When applied to the state-of-the-art optical fiber deployed in many of our metro networks and in our intercity network, this technology can dramatically increase the capacity of an optical fiber

Switching Technology

There are two widely used switching technologies currently deployed in communications networks circuit-switching systems and packet-switching systems Circuit switch-based communications systems, which currently dominate the public telephone network, establish a dedicated channel for each communication (such as a telephone call for voice or fax), maintain the channel for the duration of the call, and disconnect the channel at the conclusion of the call

Packet switch-based communications systems, which format the information to be transmitted into a series of shorter digital messages called "packets," are the preferred means of data transmission Each packet consists of a portion of the complete message plus the addressing information to identify the destination and return address A key feature that distinguishes Internet architecture from the public telephone network is that on the packet-switched Internet, a single dedicated channel between communication points is not required

Packet switch-based systems offer several advantages over circuit switch-based systems, particularly the ability to commingle packets from several communications sources together simultaneously onto a single channel For most communications, particularly those with bursts of information followed by periods of "silence," the ability to commingle packets provides for superior network utilization and efficiency, resulting in more information being transmitted through a given communication channel

IP technology, an open protocol that allows unrelated computer networks to exchange data, is the technological basis of the Internet The Internet's explosive growth in recent years has focused intensive efforts worldwide on developing IP-based networks and applications In contrast to protocols like ATM, which was the product of elaborate negotiations between the world's monopoly telephone companies, IP is an open standard, subject to continuous improvement

We believe that a form of IP-based switching will eventually replace both ATM and circuit switched technologies, and will be the foundation of integrated networks that treat all transmissions — including voice, fax and video — simply as forms of data transmission Although not always the case, voice over IP technology now incorporates the quality of service necessary for commercial deployments, but the pricing of equipment that must be installed at customer locations in order to implement voice over IP applications is not yet cost-effective for widespread application We expect that over time improved technology and the manufacture of sufficient volumes of equipment will make customer adoption of voice over IP applications more cost-effective

We have constructed IP points of presence in all of our major markets using high-capacity IP routers, through which we offer Internet-related services We currently connect these points of presence with our inter-city fiber network, which serves as our OC-192 IP backbone

We have deployed a number of next generation switching technologies, including soft-switch, optical and Ethernet switching technologies The soft-switch is a distributed computer system that performs the same functions as a circuit switch It can route and switch information at an extremely fast rate Initially, we will use soft-switch technology to complement and relieve traffic from our circuit switches We have deployed optical switching, routing and transmission equipment on our inter-city network to create an all-optical network This technology is designed to make significant amounts of bandwidth available to our customers It also is designed to enable us to more effectively and efficiently manage our customers' transmissions and to enhance our deployment of dense wavelength division multiplexing technology Optical switching will support all transmission protocols, including IP, ATM, and frame relay We also are deploying Ethernet switching technology to support and expand our Ethernet services

We believe that the deployment of IP and soft-switch technologies in our network will enable us to implement new services based on current IP technology, and position us to adopt future IP technology implementations as they evolve to support fully integrated communications networks

Fixed Wireless Technology

We hold licenses for 1,150 to 1,300 MHz of local multipoint distribution services, or LMDS, spectrum in 58 cities, covering areas where 95% of the population of the 30 largest U S cities live or work Our licenses also include 150 MHz of LMDS spectrum in 10 smaller cities and 300 MHz of spectrum in the five boroughs that comprise New York City We also hold ten fixed wireless licenses in the 39 gigahertz, or GHz, frequency Eight such licenses provide from 100 to 300 additional MHz in four cities where we hold a 150 MHz LMDS license and

two 39 GHz licenses provide us with 200 MHz of fixed wireless capacity in Las Vegas, where we do not hold a LMDS license

The spectrum under the licenses we hold is not suitable for mobile telephones, but can transmit voice, data or video signals from one fixed antenna to one or many others As the word "local" in the local multipoint distribution service name implies, the radio links provided using LMDS frequencies are of limited distance, typically of a few miles or less, due to the degradation of these high-frequency signals over greater distances The same is true of the 39 GHz spectrum Although technology to support the multipoint characteristics of this spectrum has not been developed, we use the spectrum for point-to-point connections in those limited situations where it is more cost-efficient than installing a fiber cable or leasing facilities from the incumbent carrier

A wireless connection typically consists of paired antennas placed at a distance of up to 2 5 miles from one another with a direct, unobstructed line of sight The antennas are typically installed on rooftops, towers or windows Because these connections are affected by rain attenuation, in areas of heavy rainfall transmission links are engineered for shorter distances and greater power to maintain transmission quality, which tends to increase the cost of service coverage

With the 39 GHz spectrum, because there are existing users of that spectrum, we as a new user of the spectrum will be required to coordinate our use so as not to interfere with an existing user We do not believe that the coordination process will significantly limit our ability to make use of the spectrum

The term of the licenses for our fixed wireless spectrum generally is ten years, and the initial term of a few licenses expires as early as 2006 Although the licenses are renewable for an additional ten year term, renewal is conditioned on us satisfying certain utilization requirements established by the Federal Communications Commission, or FCC Our current utilization may not be sufficient to satisfy this condition for certain licenses, and, unless we begin to use substantially more fixed wireless spectrum, the FCC may not renew one or more of our licenses

Sales and Customer Care

Overview

Our sales organization includes a direct field sales force and alternative sales channels Our direct sales force for services other than shared tenant services includes two sales organizations Our market sales organization focuses on small to medium-sized customers and larger or growing businesses within a market and multi-market accounts Our national sales organization focuses on targeted larger and national accounts, and specific enterprise and carrier channels

Our market sales organization focuses on selling our full suite of services to small to medium and larger businesses and multi-market accounts Our market research indicates that these customers prefer a single source for all of their telecommunications requirements, including products, billing, installation, maintenance, and customer service By offering these customers our local and long distance services or our XOptions packages, which combine local and long distance voice services, Internet access and web hosting services, we believe we provide our customers a level of convenience that generally is unavailable in the communications marketplace

We market and sell services to other telecommunications carriers and large commercial users and national accounts through our national sales team The expansion of our data service capabilities has enabled our national sales team to expand our targeted customers to include larger national and multi-market accounts customers that can benefit from our broad range of services

We market and sell our shared tenant services through a separate direct sales force, which targets high concentrations of business customers in multi-tenant commercial office buildings in the metropolitan areas in which we provide this service

Direct Sales Force

We have established highly motivated and experienced direct sales forces Our strategy is to design the structure of our sales efforts so that our sales personnel are able to establish a direct and personal relationship with our customers We seek to recruit salespeople with strong sales and telecommunications backgrounds, including salespeople from long distance companies, telecommunications equipment manufacturers, network systems integrators and the incumbent carriers Salespeople are offered incentives through a commission structure that generally targets 40% to 50% of a salesperson's total compensation to be based on performance The size of our

sales organization decreased from 2001 to 2002, from approximately 1,750 employees at December 31, 2001 to approximately 1,100 employees at December 31, 2002

Other Sales Channels

We have complemented our direct sales force by developing alternative sales channels to distribute the increasing number of products and services available to our broadening customer base These channels include numerous third party sales agents We currently have distribution arrangements with a number of national, regional and local agents and agency firms, whose representatives market a broad range of XO services We have a staff of approximately 65 employees who manage our agent relationship and the over 500 indirect agents in markets throughout the United States We also sell and market certain services via our telesales operation and via the Internet at www xo com

Customer Care

Once a customer's services have been installed, our customer care operations support customer retention and satisfaction Our goal is to provide customers with a customer care group that has the ability and resources to respond to and resolve customer questions and issues as they arise, 24 hours a day, seven days a week In 2002, although we conducted much of our customer care operations from four call centers, we also provided locally-based care for many large customers Although we believe that a centralized care structure not only takes advantage of economies of scale, but also enables us to provide better customer service, we intend to close one of our care facilities in 2003 and are evaluating whether to place additional customer care resources locally The size of our customer care organization decreased from 2001 to 2002, from approximately 1,000 employees at December 31, 2001 to approximately 700 employees at December 31, 2002

Regulatory Overview

Overview

The Telecommunications Act of 1996, or the Telecom Act, which substantially revised the Communications Act of 1934, has established the regulatory framework for the introduction of competition for local telecommunications services throughout the United States by new competitive entrants such as us Prior to the passage of the Telecom Act, states typically granted an exclusive franchise in each local service area to a single dominant carrier - often a former subsidiary of AT&T, known as a Regional Bell Operating Company, or RBOC - which owned the entire local exchange network and operated a virtual monopoly in the provision of most local exchange services in most locations in the United States The RBOCs, following some recent consolidation, now consist of the following companies BellSouth, Verizon, Qwest Communications and SBC Communications

Among other things, the Telecom Act preempts state and local governments from prohibiting any entity from providing telecommunications service, which has the effect of eliminating prohibitions on entry that existed in almost half of the states at the time the Telecom Act was enacted At the same time, the Telecom Act preserved state and local jurisdiction over many aspects of local telephone service, and, as a result, we are subject to varying degrees of federal, state and local regulation Consequently, federal, state and local regulation, and other legislative and judicial initiatives relating to the telecommunications industry could significantly affect our business

We believe that the Telecom Act provided the opportunity to accelerate the development of competition at the local level by, among other things, requiring the incumbent carriers to cooperate with competitors' entry into the local exchange market We have developed our business and designed and constructed our networks to take advantage of the features of the Telecom Act that require cooperation from the incumbent carriers, and believe that the continued viability of the provisions relating to these matters is critical to the success of the competitive regime contemplated by the Telecom Act

Although the Telecom Act and the related rules governing competition issued by the FCC, as well as pro-competitive policies already developed by state regulatory commissions, have enabled new entrants like us to capture a portion of the incumbent carriers' market share of local services, there have been numerous attempts to limit or eliminate the basic framework for competition in the local exchange services market established by the Telecom Act through a combination of federal legislation, new rulemaking by the FCC and challenges to existing and proposed regulations by the incumbent carriers We expect these efforts to limit the benefits of the Telecom Act to continue Successfully implementing our business plan is predicated on the assumption that the basic competitive framework will remain in place

Federal Regulation

The FCC exercises jurisdiction over our communication facilities and services We have authority from the FCC for the installation, acquisition or operation of our wireline network facilities to provide facilities-based international services In addition, we have obtained FCC authorizations for the operation of our LMDS and 39 GHz fixed wireless facilities Unlike incumbent carriers, we are not currently subject to price cap or rate of return regulation, which leaves us free to set our own pricing policies for end user services subject only to the general federal guidelines that our charges for interstate and international services be just, reasonable, and nondiscriminatory The FCC does authorize us to file interstate tariffs on an ongoing basis for interstate access (rates charged among carriers for access to their networks) The FCC, however, has issued a decision that required us (with only minor exceptions) to withdraw tariffs for interstate domestic long distance service and international long distance service We, however, still are required to make the terms, conditions and pricing of the detariffed services available to the public on our Company web page

The following is a summary of the interconnection and other rights granted by the Telecom Act that are most important for full local competition and our belief as to the effect of the requirements, if properly implemented

- Interconnection with the networks of incumbents and other carriers, which permits customers of ours to exchange traffic with customers connected to other networks,
- Local loop unbundling, which allows us to selectively gain access to incumbent carriers' facilities and wires that connect the incumbent carriers' central offices with customer premises, thereby enabling us to serve customers on a facilities basis not directly connected to our networks,
- Reciprocal compensation, which mandates arrangements for local traffic exchange between us and both incumbent and competitive carriers and compensation for terminating local traffic originating on other carriers' networks, thereby improving our margins for local service,
- Number portability, which allows customers to change local carriers without changing telephone numbers, thereby removing a significant barrier for a potential customer to switch to our local voice services,
- Access to phone numbers, which mandates assignment of new telephone numbers to our customers, thereby enabling us to provide telephone numbers to new customers on the same basis as the incumbent carrier, and
- Collocation of telecommunications equipment in incumbent central offices, which enables us to have direct access to unbundled loops and other network elements and facilitates their efficient integration with our switching and other network facilities

In January 1999, the U S Supreme Court upheld key provisions of the FCC rules implementing the Telecom Act, in a decision that was generally favorable to competitive telephone companies such as us In finding that the FCC has general jurisdiction to imp lement the Telecom Act's local competition provisions, the Supreme Court confirmed the FCC's role in establishing national telecommunications policy, and thereby created greater certainty regarding the rules governing local competition going forward

Although the rights established in the Telecom Act are a necessary prerequisite to the introduction of full local competition, they must be properly implemented and enforced to permit competitive telephone companies like us to compete effectively with the incumbent carriers Discussed below are several FCC and court proceedings relating to the application of certain FCC rules and policies that are significant to our operations

Unbundling of Incumbent Network Elements

In the January 1999 Supreme Court decision discussed above, the Court affirmed the FCC's interpretation of matters related to unbundling of incumbent carriers' network elements It held that the FCC correctly interpreted the meaning of the term "network element", which defines the parts of an incumb ent carrier's operations that may be subject to the "unbundling" requirement of the Telecom Act The Court, however, also held that the FCC did not correctly determine which network elements must be unbundled and made available to competitive telephone companies such as us In November 1999, the FCC released its "UNE (unbundled network element) Remand Order", which addressed the deficiencies in the FCC's original ruling cited by the Supreme Court The order generally was viewed as favorable to us and other competitive carriers because it ensured that incumbent carriers

would be required to continue to make available those network elements, including unbundled loops, that are crucial to our ability to provide local and other services The UNE Remand Order subsequently was appealed by the incumbent carriers

On May 24, 2002, the United States Court of Appeals for the D C Circuit released an opinion remanding the UNE Remand Order to the FCC for further consideration The Court of Appeals stated that it had remanded the order because it felt that

- the FCC had adopted uniform national rules with respect to almost every unbundled element for every geographic market without regard to the state of competition in any particular market, and
- the FCC's determination of when cost disparities impair a competitor's ability to provide service without unbundled elements was too broad

In response to the Court of Appeals ' decision, and as part of its statutorily required periodic review of its list of unbundled elements, the FCC initiated its "Triennial Review" proceeding

On February 20, 2003, the FCC held an open meeting and adopted its Triennial Review decision The full text of what is expected to be a 300-page order is not yet available, so we have only a broad outline of the FCC's actions without the detail required to clearly understand all of the ramifications of this important decision Based on the FCC's press release and the comments of each FCC Commissioner at the meeting, it appears that, under that order, our ability to obtain access to certain unbundled network elements and incumbent network upgrades will be curtailed or more costly in the future Also, it appears that the order would delegate to the states the overall responsibility for deciding what unbundled elements should be available to competitors like us in local markets of each of the respective states Delegation of these determinations creates the risk that some states may decide to limit or eliminate unbundled elements to which we have access today and that we will be faced with different sets of rules and costs if states issue inconsistent decisions

Based on the FCC's press release announcing the Triennial Review decision and related comments of the Commissioners, the following matters may be of relevance to us once the order is issued

- Curtailed Access to Broadband It appears that the order will adopt new rules that would restrict competitive carriers from leasing as unbundled elements certain upgrades that the incumbent carriers make to their networks, such as the deployment of new optical fiber or upgrades from copper to optical fiber For example, a new fiber loop to a customer that replaces an existing copper loop could be exempt from unbundling, except that incumbents must continue to unbundle the pre-existing copper loop or provide a voice channel for us on the new fiber loops that is equivalent to the old copper loop Although the imposition of any restrictions on our access to the incumbents' broadband networks is not a favorable development for us, we believe that the adverse impact is partially mitigated by the fact that it appears that incumbents would be required to continue to provide us with basic access to those facilities that we currently lease from them to serve many of our customers
- Unbundled Local Loops' It appears that the order will make a general, national finding that competitive carriers should have access to certain unbundled loops of the incumbent carriers The states, however, may remove competitive carriers' access to such loops based on the results of specified competitive analyses Incumbent carriers will no longer be required to provide competitive carriers with access to certain very high-capacity loops. We believe that the net result of such an order would not have a significant impact on us, as the access to the vast majority of unbundled loops that we use today would be preserved
- Unbundled Transport It appears from the press release announcing the Triennial Review decision that the order will change the definition of "dedicated transport" in such a way that competitive carriers would have to purchase certain transport facilities at higher rates than they do so today It appears that the order would maintain access to many types of transport between incumbent facilities, such as transport between incumbent central offices, but it redefines transport to eliminate the unbundling of other transport It also appears that the order would set forth a test that the states must follow in considering whether transport should be available in local markets within the states It appears that the order will provide that certain very high-capacity transport would no longer be available as an unbundled element and that shared transport would be unavailable as an unbundled element in mo st business markets Although it is not possible to gauge the full effect of these changes without seeing the text of the order, we believe that it is likely that these actions would raise our costs for transport services in the future

- Enhanced Extended Links and Co-mingling It appears that the order will facilitate the ability of competitive carriers like us to obtain a loop and transport combination of unbundled elements known as "enhanced extended links", provided that the underlying loop and transport elements are available on an unbundled basis It also appears that the order will permit competitive carriers to mix unbundled network elements with retail services instead of requiring them to artificially segregate unbundled elements from the remainder of our network Because we currently take advantage of both services from the incumbent carriers, we believe that these developments could result in cost savings for us

- Calculation of Unbundled Element Rates It appears that the order will allow the incumbent carriers to utilize a higher cost of capital and shorter depreciation lives to establish rates for unbundled elements We believe that these modifications could raise our costs for leasing unbundled elements in the future

As indicated above, the text of the Triennial Review decision has not yet been released We anticipate that, once the FCC's new unbundling rules are effective, incumbent carriers will pursue review in courts, institute administrative proceedings with the FCC and state regulatory agencies and lobby the United States Congress, all in an effort to affect laws and regulations in a manner even more favorable to them and against the interest of competitive carriers At the same time, we would anticipate that the competitive carriers will endeavor to improve their positions and access to the incumbents' networks through similar means

Collocation in Incumbent Central Offices

Collocation regulations promulgated by the FCC specify in greater detail obligations that the Telecom Act imposes upon the incumbent carriers to open their local networks to competition by providing competitors space to locate their equipment in incumbent central offices and remote terminals for the purpose of interconnection This allows the competitive carriers to provide local telephone services and to use portions of the incumbent carriers' existing networks to offer new and innovative services Over the past four years, the FCC's collocation regulations have been the subject of very contentious proceedings at the FCC and litigation before several courts On remand from a March 2000 decision by the U S Court of Appeals for the D C Circuit, the FCC issued a decision that revised its rules in a manner that permits incumbent companies to exercise more discretion in determining the placement of competitors' equipment in their central offices, and does not require the incumbents to allow competitors to install and maintain cross-connections between other collocated competitors, but requires the incumbents themselves to provide this as part of their collocation services In June, 2002, the D C Circuit Court of Appeals affirmed the FCC's remand order, and the FCC has since clarified that incumbents should make their cross-connection service available in the physical collocation tariffs they file with the FCC

In October 2002, Verizon filed an application with the FCC requesting authority to discontinue providing federally-tariffed physical collocation services, as required under current FCC regulations applicable to most incumbent carriers Verizon asked the FCC to require its competitors instead to order collocation services solely pursuant to terms and conditions approved by state public service commissions Verizon's application remains pending, but if this authority is granted, such discontinuance would make it more costly and difficult for competitors such as us to obtain collocation services because the rates set by state public service commissions are typically significantly higher than those approved by the FCC, and may require competitors to engage in costly negotiations in different states If Verizon is successful, other large incumbent providers are likely to seek and receive comparable relief

Regulation of the RBOCs' Ability to Provide Long Distance Service

The FCC has primary jurisdiction over the implementation of Section 271 of the Telecom Act, which provides that the RBOCs cannot offer in-region long distance services until they have demonstrated that

- they have entered into an approved interconnection agreement with a facilities-based competitive telephone company or that no such competitive telephone company has requested interconnection as of a statutorily determined deadline,

- they have satisfied a 14-element checklist designed to ensure that the RBOC is offering access and interconnection to all local exchange carriers on competitive terms, and

- the FCC has determined that allowing the RBOC to offer in-region, long distance services is consistent with the public interest, convenience and necessity

The FCC has granted each of the RBOCs the authority to provide long distance service in a number of states We expect that the RBOCs will have received such authority with respect to most of the remaining states in the near term Although we cannot predict when such approval is likely to occur, it could have an adverse affect on our ability to compete if it is not accompanied by safeguards to ensure that the RBOC continues to comply with the market-opening requirements of Section 271 or if it is granted prematurely before the RBOC has completely satisfied the market-opening requirements

Provision of Broadband Telecommunications Services and Information Services

Current federal and state regulation places certain restrictions and conditions on the provision of advanced telecommunications services, or broadband services, such as data and DSL services, by the RBOCs Furthermore, the network elements that RBOCs must make available under the FCC's unbundling rules to competitors may be used for the provision of broadband services However, at the urging of the RBOCs and other incumbent carriers, the FCC in its Triennial Review decision, appears to have greatly curtail the extent to which the incumbents must unbundle the broadband portion of their networks for their competitors Despite this apparent victory, the RBOCs have vowed to continue to push for further deregulation through federal and state legislative efforts For example, broadband deregulation legislation is currently under consideration in several states, including Georgia, Texas and Missouri In addition, it is anticipated that deregulatory legislation will be pursued by the RBOCs in Congress In addition to possible legislation, the FCC has initiated another pending proceeding that could result in a further diminishment of incumbent carriers' requirement to make unbundled network elements that are used for certain broadband or information services available to us The FCC has issued a Notice of Proposed Rulemaking entitled "Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities" that requests comments on the proper classification of broadband access services as either regulated telecommunications services or unregulated information services The Triennial Review decision significantly restricts the availability on an unbundled basis of certain network elements deploying fiber or packet-switching technologies That decision, in conjunction with a decision in this proceeding, legislative change or a court ruling further broadening the definition of what constitutes unregulated information services could have the effect of allowing RBOCs to provide terms, conditions and pricing to their own affiliates that provide data or information services that are better than those made available to us Such developments could also be expected to adversely effect our cost of doing business by increasing the cost of purchasing or leasing such facilities from the RBOCs

Universal Service

In 1997, the FCC established a significantly expanded federal telecommunications subsidy regime known as "universal service" For example, the FCC established new subsidies for services provided to qualifying schools and libraries and rural health care providers, and expanded existing subsidies to low income consumers Most telecommunications companies, including us, must pay for these programs based on their share of interstate and international telecommunications end user revenues In a 1999 decision, the Fifth Circuit Court of Appeals issued a ruling that had the net effect of somewhat lowering our contribution of revenues to universal service, which stands at 7 28% of end user telecommunications revenues for the first quarter of 2003 Now, the FCC has taken further steps to modify the system for assessment and recovery of universal service funds In a December 2002 Notice of Proposed Rulemaking, the FCC has asked many broad-ranging questions regarding universal service, including whether to change its method of assessing contributions due from carriers by basing it on the number and capacity of connections they provide, rather than on interstate and international end user revenues they earn We cannot be sure that legislation or FCC rulemaking will not increase the size of our subsidy payments, the scope of the subsidy program or our costs of calculating, collecting and remitting the universal service related payments

Intercarrier Compensation Reform

Currently, communications carriers are required to pay other carriers for interstate access charges and local reciprocal compensation charges, both of which are being considered for reform

Interstate Access Charges Long distance carriers pay local facilities-based carriers, including us, interstate access charges for both originating and terminating the interstate calls of long distance customers on the local carriers' networks Historically, the RBOCs set access charges higher than cost and justified this pricing to regulators as a subsidy to the cost of providing local telephone service to higher cost customers. With the establishment of an explicit and competitively neutral universal service subsidy mechanism, however, the FCC is under increasing pressure to revise the current access charge regime to bring the charges closer to the cost of providing access In response, the FCC issued a decision in 2001 setting the rates that competitive local

carriers charge to long distance carriers at a level that will gradually decrease over three years from a maximum of $0 025 per minute to the rates charged by incumbent carriers So long as we are in compliance with the FCC's rate schedule, the FCC's order forbids long distance carriers from challenging our interstate access rates Although this FCC decision lowering access charges will reduce our access charge revenues over time, we do not expect that such a reduction will have a material impact on our total revenues or financial position The FCC is also considering, in a declaratory ruling proceeding commenced in November 2002, the question of whether voice over the Internet services or services utilizing an Internet protocol should be made subject to interstate access charges in the same manner as traditional telephony Like a growing number of carriers, we utilize an Internet protocol for a portion of our traffic as do some of our customers The FCC has indicated on several occasions that such services are exempt from interstate access charges, but until the FCC issues its ruling in the current proceeding, it is unclear how such traffic will be treated for intercarrier compensation purposes

Local Reciprocal Compensation Charges Local telephone companies such as us that originate traffic that is terminated on the network of other carriers typically compensate the other local carriers for terminating that traffic These payments flow in both directions between any two carriers First, when we terminate traffic for another local carrier to a customer on our network, we collect compensation Second, when we send traffic to another carrier for termination, we pay compensation Some competitors, however, have a customer base that generates many more minutes of terminating traffic from other carriers than originating traffic destined for other carriers For example, a competitor that has a customer base that has many information service providers typically will have a large amount of compensation being paid to it by other carriers, while it will owe very little reciprocal compensation to other carriers The FCC revamped the local reciprocal compensation structure in 2001 on an interim basis for three years to eliminate or reduce the opportunity for carriers to take advantage of an imbalance of originating and terminating traffic flows due to traffic terminated to information service providers The FCC also initiated a rulemaking to examine inter-carrier compensation more comprehensively Under the decision, at the election of the incumbent carrier, terminating traffic that is out-of-balance by a ratio of more than 3 to 1 can be compensated at a lower rate, or in some cases, at no charge Because the traffic we exchange with other local carriers is relatively in balance across our markets, however, we do not expect FCC decisions to restructure reciprocal compensation to have a material impact on our total revenues or financial position vis-à-vis other carriers

Regulation of Business Combinations

The FCC, along with the Department of Justice and state commissions, has jurisdiction over business combinations involving telecommunications companies For example, the FCC's approval was required to implement certain aspects of our Chapter 11 reorganization The FCC has reviewed a number of recent and proposed combinations to determine whether the combination would undermine the market-opening incentives of the Telecom Act by permitting the combined company to expand its operations without opening its local markets to competition or have other anti-competitive effects on the telecommunications and Internet access markets In some cases, the FCC has set conditions for its approval of the proposed business combination We cannot predict whether any conditions imposed will be effective, nor can we predict whether the FCC will impose similar conditions should it approve future business combinations

State Regulation

State regulatory commissions retain jurisdiction over our facilities and services to the extent they are used to provide intrastate communications We expect that we will be subject to direct state regulation in most, if not all, states in which we operate in the future Many states require certification before a company can provide intrastate communications services We are certified in all states where we have operations and certification is required We cannot be sure that we will retain such certifications or that we will receive authorization for markets in which we expect to operate in the future

Most states require us to file tariffs or price lists setting forth the terms, conditions and prices for services that are classified as intrastate In some states, our tariff can list a range of prices for particular services In other states, prices can be set on an individual customer basis Several states where we do business, however, do not require us to file tariffs We are not subject to price cap or to rate of return regulation in any state in which we currently provide service

Under the regulatory arrangement contemplated by the Telecom Act, state authorities continue to regulate matters related to universal service, public safety and welfare, quality of service and consumer rights All of these

regulations, however, must be competitively neutral and consistent with the Telecom Act, which generally prohibits state regulation that has the effect of prohibiting us from providing telecommunications services in any particular state State commissions also enforce some of the Telecom Act's local competition provisions, including those governing the arbitration of interconnection disputes between the incumbent carriers and competitive telephone companies and the setting of rates for unbundled network elements Finally, the order expected from the FCC's Triennial Review decision will delegate to the states important authority to decide what unbundled elements must be made available to competitive carriers in each of the states' local markets over a period three to nine months following the effectiveness of the decision Consequently, this authority would give the states a key role regarding our continuing access to unbundled elements, such as loops and transport in particular, that are necessary in many cases to connect our customers to our metro networks

Local Government Regulation

In certain locations, we must obtain local franchises, licenses or other operating rights and street opening and construction permits to install, expand and operate our fiber-optic networks in the public right-of-way In some of the areas where we provide network services, our subsidiaries pay license or franchise fees based on a percentage of gross revenues or on a per linear foot basis Cities that do not currently impose fees might seek to impose them in the future, and after the expiration of existing franchises, fees could increase Under the Telecom Act, state and local governments retain the right to manage the public rights-of-way and to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of public rights-of-way As noted above, these activities must be consistent with the Telecom Act, and may not have the effect of prohibiting us from providing telecommunications services in any particular local jurisdiction

If an existing franchise or license agreement were to be terminated prior to its expiration date and we were forced to remove our fiber from the streets or abandon our network in place, our operations in that area would cease, which could have a material adverse effect on our business as a whole We believe that the provisions of the Telecom Act barring state and local requirements that prohibit or have the effect of prohibiting any entity from providing telecommunications service should be construed to limit any such action Although none of our existing franchise or license agreements has been terminated, and we have received no threat of such a termination, there can be no assurance that one or more local authorities will not attempt to take such action Nor is it clear that we would prevail in any judicial or regulatory proceeding to resolve such a dispute

Environmental Regulation

Our switch site and customer premise locations are equipped with back-up power sources in the event of an electrical failure Each of our switch site locations has battery and diesel fuel powered back-up generators, and we use batteries to back-up some of our customer premise equipment Federal, state and local environmental laws require that we notify certain authorities of the location of hazardous materials and that we implement spill prevention plans We believe that we currently are in compliance with these requirements in all material respects

Competition

The industry environment in which we operate has changed significantly recently In particular, with the steep decline in the market valuations of debt and equity securities of telecommunications companies, particularly emerging providers, in the last two years the financial condition of many competitive and other carriers has deteriorated, and a number of these competitors have attempted to reorganize, or have completed reorganizations, under Chapter 11 of the Bankruptcy Code Several competitors who have completed these reorganization efforts, have emerged from bankruptcy with significant improvements to their financial condition or are newly formed entities that have acquired the assets of others at substantial discounts when compared to their original cost basis

At the same time, the regulatory environment has changed and continues to change rapidly Although the Telecom Act and other actions by the FCC and state regulatory authorities have had the general effect of promoting competition in the provision of communications services, it also has allowed the incumbent carriers to begin to provide long distance services in many states These effects, together with new technologies, such as voice-over-IP, and the importance of data services, have blurred the distinctions among traditional communications markets As a result, a competitor in any of our business areas potentially is a competitor in our other business areas

Many of our existing and potential competitors have greater market presence, including name recognition, engineering and marketing capabilities, and financial, technological and personnel resources, including resources for the development and deployment of new technology and services, than those available to us

Incumbent Carriers

In each market that we serve, we face, and expect to continue to face, significant competition from the incumbent carriers, which currently dominate the local telecommunications markets, primarily the RBOCs, which include BellSouth, Verizon, Qwest Communications and SBC Communications We compete with the incumbent carriers in our markets for local exchange and other services on the basis of product offerings, quality, capacity and reliability of network facilities, state-of-the-art technology, price, route diversity, ease of ordering and customer service However, the incumbent carriers have long-standing relationships with their customers and provide those customers with various transmission and switching services that we, in many cases, do not currently offer Competition, however, is not based on any proprietary technology Because our fiber optic networks have been recently installed compared to those of the incumbent carriers, our networks' dual path architectures and state-of-the-art technology may provide us with cost, capacity, and service quality advantages over some existing incumbent carrier networks Incumbent carriers also have received regulatory approval to provide and have begun to provide long distance voice service in a number of regions

Other Voice Service Competitors

We face, and expect to continue to face, competition for local and long distance telecommunications services from competitors and potential competitors in addition to the incumbent carriers, primarily AT&T, WorldCom, Inc and Sprint Corporation With respect to local telecommunications services, we also face, and expect to continue to face, competition from other carriers and competitors, such as Time Warner Telecom, Allegiance Telecom Inc , Focal Communications and McLeodUSA Incorporated With respect to long distance telecommunications services, although the market is dominated by AT&T, WorldCom, and Sprint, hundreds of other companies, such as Qwest, also compete in the long distance marketplace In addition, as the RBOCs continue to receive FCC authorization to increase the number of states in which they are authorized to provide long distance telecommunications services, we would expect them to become increasingly significant competitors for those services

Data Service Competitors

We face, and expect to continue to face, competition for Internet access and other data services from telecommunications companies, including AT&T, WorldCom, and Sprint, online service providers, DSL service providers, and Internet service providers and web hosting providers

Other Business Competitors

Our enhanced communications service offerings are also subject to competition For example, there are several competitors that offer interactive voice response services similar to those offered by our Interactive division, such as Basis, Interactive Telesis and West Corporation, which we believe focus their sales efforts on large volume interactive voice response service users, live agent call centers and IVR hardware sales

Employees

As of December 31, 2002 we employed approximately 5,100 and as of February 28, 2003, we employed approximately 4,900 people, including full-time and part-time employees We consider our employee relations to be good None of our employees is covered by a collective bargaining agreement

Risk Factors

Risks Related to Our Operations

The wave of bankruptcies in the Internet and communications-related industries has diminished our marketing prospects and may have an adverse effect on the results of our operations in future periods.

We historically have provided services to, and generated significant revenues from, customers that conduct business in the Internet and communications-related segments Many businesses that operated in those segments, particularly start-ups in the Internet service provider segment, have liquidated, otherwise gone out of business, or modified their business plans in ways that have significantly reduced their need for communications services These developments have decreased the size of the potential market for many of our wholesale and carrier-related services, particularly data transport services Those of our Internet and communications-related customers that remain in business and have not sought bankruptcy protection nevertheless have been adversely affected by recent business trends in the sectors To the extent the credit quality of these customers deteriorates or these customers seek

bankruptcy protection, we may not be able to collect all amounts due from them and our ability to generate revenue in future periods from them could be adversely affected

The failure of our operations support systems to perform as we expect could impair our ability to retain customers and obtain new customers, or provision their services, or result in increased capital expenditures, which would adversely affect our revenues or capital resources.

Our operations support systems are an important factor in our success Critical information systems used in daily operations perform sales and order entry, provisioning, billing and accounts receivable functions, and cost of service verification and payment functions, particularly with respect to facilities leased from incumbent carriers If any of these systems fail o r do not perform as expected, it would impact our ability to process orders and provision sales, and to bill for services efficiently and accurately, which could cause us to suffer customer dissatisfaction, loss of business or the inability to add customers on a timely basis, any of which would adversely affect our revenues In additional, system failure or performance issues could impact our ability to effectively audit and dispute invoicing and provisioning data provided by service providers from whom we lease facilities Furthermore, problems may arise with higher processing volumes or with additional automation features, which could potentially result in system breakdowns and delays and additional unanticipated expense to remedy the defect or to replace the defective system with an alternative system

We are in the process of updating and replacing software and related systems for sales tracking, order entry and provisioning and plan to implement changes to our billing systems later this year to support our growth and improve the order and provisioning processes We have experienced, and may continue to experience, delays and related problems in processing orders, provisioning sales and billing in connection with the transition to these new systems Our ability to efficiently and accurately provision new orders for services on a timely basis is necessary for us to begin to generate revenue related to those services If the delays or related problems continue, or if any unforeseen problems emerge in connection with our migration to the new provisioning software and systems, delays and errors may occur in the provisioning process, which could significantly increase the time until an order for new service can begin to generate revenue, which could have a material adverse effect on our operations

It is expensive and difficult to switch new customers to our network, and lack of cooperation of the incumbent carrier can slow the new customer connection process, which could impact our ability to compete.

It is expensive and difficult for us to switch a new customer to our network because

- we charge the potential customer certain one-time installation fees, and, although the fees are less than the cost to install a new customer, they may act as a deterrent to become our customer, and
- we require cooperation from the incumbent carrier in instances where there is no direct connection between the customer and our network, which can complicate and add to the time that it takes to provision a new customer's service

Our principal competitors, the incumbent carriers, are already established providers of local telephone services to all or virtually all telephone subscribers within their respective service areas Their physical connections from their premises to those of their customers are expensive and difficult to duplicate To complete the new customer provisioning process, we rely on the incumbent carrier to process certain information The incumbent carriers have a financial interest in retaining their customers, which could reduce their willingness to cooperate with our new customer provisioning requests

We depend on our key personnel and qualified technical staff and, if we lose their services, our ability to manage the day-to-day aspects of our complex network will be weakened. We may not be able to hire and retain qualified personnel, which could adversely affect our operating results.

We are highly dependent on the services of our management and other key personnel The loss of the services of our senior executive management team or other key personnel could cause us to make less successful strategic decisions, which could hinder the introduction of new services or make us less prepared for technological or marketing problems, which could reduce our ability to serve our customers or lower the quality of our services In particular, the position of chief executive officer is currently vacant, and the designation of a new chief executive officer may have a significant impact on our future performance

We believe that a critical component for our success will be the attraction and retention of qualified, professional technical and sales personnel We have experienced intense competition for qualified personnel in our business with the sales, technical and other skill sets that we seek We may not be able to attract, develop, motivate and retain experienced and innovative personnel If we fail to do so, there will be an adverse effect on our ability to generate revenue and operate our business

Our rights to the use of the dark fiber that make up our network may be affected by the financial health of our fiber providers.

We hold some of the fiber that makes up the foundation of our network, particularly in our inter-city network, through long-term leases or indefeasible right of use agreements A bankruptcy or financial collapse of one of these fiber providers could result in a loss of our rights under such leases and agreements with the provider, which in turn could have a negative impact on the integrity of our network and ultimately on our results of operations Since early 2001, there has been increasing financial pressure on some of our fiber providers as part of the overall weakening of the telecommunications market Several such providers have sought bankruptcy protection To our knowledge, the rights of the holder of such rights in strands of fiber have never been addressed by the judiciary at the state or federal level in bankruptcy and, therefore, under such circumstances, our rights under dark fiber agreements would be unclear

We may not be able to continue to connect our network to the incumbent carrier's network or maintain Internet peering arrangements on favorable terms, which would impair our growth and performance.

We must be a party to interconnection agreements with the incumbent carrier and certain independent carriers in order to connect our customers to the public telephone network If we are unable to renegotiate or maintain interconnection agreements in all of our markets on favorable terms, it could adversely affect our ability to provide services in the affected markets

Peering agreements with Internet service providers allow us to access the Internet and exchange transit for free with these providers Depending on the relative size of the carriers involved, these exchanges may be made without settlement charge Recently, many Internet service providers that previously offered peering have reduced or eliminated peering relationships or are establishing new, more restrictive criteria for peering and an increasing number of these service providers are seeking to impose charges for transit Increases in costs associated with Internet and exchange transit could have a material adverse effect on our margins for our products that require Internet access We may not be able to renegotiate or maintain peering arrangements on favorable terms, which would impair our growth and performance

If our selection of IP technology is incorrect, ineffective or unacceptably costly, implementation of our business strategy coul d be delayed, which would adversely affect our growth and operating results.

We rely on IP technology as the basis for our metro and intercity networks Integrating this technology into our network may prove difficult and may be subject to delays In addition, affordable IP customer premise equipment may not become available in a timely fashion, if at all If the technology choices we make prove to be incorrect, ineffective or unacceptably costly, our strategy of meeting our customer's demand for existing and future telecommunications services using IP technology could fail, which would adversely affect our growth and operating results

Physical space limitations in office buildings and landlord demands for fees or revenue sharing could limit our ability to connect customers to our networks and increase our costs, which would adversely impact our results.

In some circumstances, connecting a customer who is a tenant in an office building to our network requires installation of in-building cabling through the building's risers from the customer's office to our fiber in the street or building equipment room, or our antenna on the roof In some office buildings, particularly the premier buildings in the largest markets, the risers are already close to their maximu m physical capacity due to the entry of other competitive carriers into the market Fixed wireless direct connections require us to obtain access to rooftops from building owners Moreover, the owners of these buildings are increasingly requiring competitive telecommunications service providers like us to pay fees or otherwise share revenue as a condition of access to risers and rooftops Although we generally do not agree to revenue sharing arrangements, we may continue to be required

to pay fees to access buildings, particularly for building located in larger markets, which would reduce our operating margins

Our reliance on third-party DSL service providers could affect adversely our ability to provide service to our DSL customers.

We provide a significant portion of our DSL service through wholesale arrangements with incumbent carriers and other DSL service providers To the extent that such DSL service providers are unable to provide wholesale DSL service to us, we in turn may be unable to provide that service to our customers if we cannot provide service on our own DSL equipment or obtain wholesale service from another DSL service provider In addition, the transition of our DSL customers' services to another source of DSL service may cause potential disruptions for the affected DSL customers' services If we are unable to serve these customers, we will lose the related revenues

Risks Related to Competition and Our Industry

Technological advances and regulatory changes are eroding traditional barriers between formerly distinct telecommunications markets, which could increase the competition we face and put downward pressure on prices, which could impair our results.

New technologies, such as voice-over-IP, and regulatory changes -- particularly those permitting incumbent local telephone companies to provide long distance services – are blurring the distinctions between traditional and emerging telecommunications markets In addition, the increasing importance of data services has focused the attention of most telecommunications companies on this growing sector As a result, a competitor in any of our business areas is potentially a competitor in our other business areas, which could impair our prospects, put downward pressure on prices and adversely affect our operating results

We face competition in each of our markets principally from the incumbent carrier in that market, but also from recent and potential market entrants, including long distance carriers seeking to enter, reenter or expand entry into the local exchange marketplace and incumbent carriers seeking to enter into the long distance market as they are granted the regulatory authority to do so This competition places downward pressure on prices for local and long distance telephone service and data services, which can adversely affect our operating results In addition, we could face competition from other companies, such as other competitive carriers, cable television companies, microwave carriers, wireless telephone system operators and private networks built by large end-users If we are not able to compete effectively with these industry participants, our operating results could be adversely affected

Many of our competitors have superior resources, which could place us at a cost and price disadvantage.

Many of our current and potential competitors have market presence, engineering, technical and marketing capabilities and financial, personnel and other resources substantially greater than ours As a result, some of our competitors can raise capital at a lower cost than we can, and they may be able to adapt more swiftly to new or emerging technologies and changes in customer requirements, take advantage of acquisition and other opportunities more readily, and devote greater resources to the development, marketing and sale of products and services than we can Also, our competitors' greater brand name recognition may require us to price our services at lower levels in order to win business Finally, our competitors' cost advantages give them the ability to reduce their prices for an extended period of time if they so choose

The technologies we use may become obsolete, which would limit our ability to compete effectively and adversely impact our results.

The telecommunications industry is subject to rapid and significant changes in technology Most technologies and equipment that we use or will use, including wireline and wireless transmission technologies, circuit and packet switching technologies, multiplexing technologies, data transmission technologies, including the DSL, ATM and IP technologies, and server and storage technologies may become obsolete If we do not replace or upgrade technology and equipment that becomes obsolete, we will be unable to compete effectively because we will not be able to meet the expectations of our customers, which could cause our results to suffer

The introduction of new technologies may reduce the cost of services similar to those that we plan to provide As a result, our most significant competitors in the future may be new entrants to the telecommunications industry

These new entrants may not be burdened by an installed base of outdated equipment and, therefore, may be able to more quickly respond to customer demands

Additionally, the markets for data and Internet-related services are characterized by rapidly changing technology, evolving industry standards, changing customer needs, emerging competition and frequent new product and service introductions The future success of our data services business will depend, in part, on our ability to accomplish the following in a timely and cost-effective manner

- effectively use leading technologies and update or convert from existing technologies and equipment,
- continue to develop technical expertise,
- develop new services that meet changing customer needs, and
- influence and respond to emerging industry standards and other technological changes

Our pursuit of necessary technological advances may require substantial time and expense

Our company and industry are highly regulated, which restricts our ability to compete in our target markets and imposes substantial compliance costs on us that adversely impact our results.

We are subject to varying degrees of regulation from federal, state and local authorities This regulation imposes substantial compliance costs on us It also restricts our ability to compete For example, in each state in which we desire to offer our services, we are required to obtain authorization from the appropriate state commission If any required authorization for any of our markets or services is revoked or otherwise terminated, our ability to operate in the affected markets would be adversely affected

Attempts to limit the basic competitive framework of the Telecom Act could interfere with the successful implementation of our business plan.

Successful implementation of our business plan is predicated on the assumption that the basic framework for competition in the local exchange services market established by the Telecom Act will remain in place We expect that there will be attempts to limit or eliminate this basic framework through a combination of federal legislation, new rulemaking by the FCC and challenges to existing and proposed regulations by the RBOCs It is not possible to predict the nature of any such action or its impact on our business and operations

The requirement that we obtain permits and rights-of-way to develop our network increases our cost of doing business and could adversely affect our performance and results.

In order for us to acquire and develop our fiber networks, we must obtain local franchises and other permits, as well as rights-of-way and fiber capacity from entities such as incumbent carriers and other utilities, railroads, long distance companies, state highway authorities, local governments and transit authorities The process of obtaining these permits and rights-of-way is time-consuming and burdensome and increases our cost of doing business

We may not be able to maintain our existing franchises, permits and rights-of-way that we need for our business We may also be unable to obtain and maintain the other franchises, permits and rights that we require A sustained and material failure to obtain or maintain these rights could materially adversely affect our performance and operating results in the affected metropolitan area

Risks Related to Liquidity and Financial Resources

We incurred a substantial net loss in 2002 and, in the near term, will not generate funds from operations sufficient to meet all of our cash requirements.

For each period since inception, we have incurred substantial net losses For 2002, we posted a net loss attributable to common stockholders of approximately $3 4 billion In the near term, our existing and projected operations are not expected to generate cash flows sufficient to pay our expected operating expenses, fund our capital expenditure requirements and meet our debt service obligations

The covenants in our New Credit Agreement restrict our financial and operational flexibility, which could have an adverse affect on our results of operations.

Our New Credit Agreement contains covenants that require us to maintain certain amounts of unrestricted cash, require us to achieve specified operating results, and restrict, among other things, the amount of our capital expenditures, our ability to borrow money, grant additional liens on our assets, make particular types of investments or other restricted payments, sell assets or merge or consolidate Arnos Corp , a company controlled by Mr Carl Icahn, holds approximately 85% of the principal amount of the loans outstanding under the New Credit Agreement Because amendments to or waivers of covenants under the New Credit Agreement generally require the approval or consent of holders of only a majority of the outstanding principal amount under the New Credit Agreement, decisions whether to amend or waive compliance with such covenants by the holders of loans under the New Credit Agreement can be made by Arnos Corp , and ultimately Mr Icahn, whether or not the other holders consent

The security for the New Credit Agreement consists of substantially all of the assets of XO Parent and our subsidiaries A default under the New Credit Agreement could adversely affect our rights under other commercial agreements

The New Credit Agreement and the existence of the loans under the New Credit Agreement also could affect our financial and operational flexibility, as follows

- they may impair our ability to obtain additional financing in the future,
- they may limit our flexibility in planning for or reacting to changes in market conditions, and
- they may cause us to be more vulnerable in the event of a downturn in our business

As a result of the recent investment history of the telecommunications sector, the access of *telecommunications* service providers like us to capital for growth or acquisitions is likely to be limited.

Telecommunications companies, including us, have experienced massive defaults on debt securities and bank loans in recent years, as well as the elimination of equity positions in the ensuing bankruptcy reorganizations This experience has made the industry one of the worst-performing investment sectors in recent years We expect that this history has lead to extremely limited, if any, access to the capital markets by companies in our industry, and that this situation may continue for some time As a result, we may have to rely entirely on cash on hand and internally generated funds from operations to finance our business in the future, which would diminish our financial and operational flexibility, and diminish our ability to take advantage of opportunities for expansion of our network and for growth through business acquisitions

Risks Related to Our New Common Stock

An affiliate controlled by Mr. Carl Icahn is our majority stockholder.

Cardiff, a company owned and controlled by Mr Carl Icahn, beneficially owns over 80% of our outstanding New Common Stock As a result, Mr Icahn has the power to elect all of our directors Under applicable law and our certificate of incorporation and by-laws, certain actions can not be taken without the approval of holders of a majority of our voting stock including, without limitation, mergers and the sale of substantially all of our assets and amendments to our certificate of incorporation and by-laws

We could be liable for the funding and termination liabilities of certain pension plans sponsored by affiliates of Mr. Carl Icahn.

As discussed above, affiliates of Mr Icahn hold over 80% of the outstanding New Common Stock of XO Parent Applicable pension and tax laws make each member of a plan sponsor's "controlled group" (generally defined as entities in which there is at least an 80% common ownership interest) jointly and severally liable for certain pension plan obligations of a plan sponsor that is a member of the controlled group These pension obligations include ongoing contributions to fund the plan, as well as liability for any unfunded liabilities that may exist at the time the plan is terminated In addition, the failure to pay these pension obligations when due may result in the creation of liens in favor of the pension plan or the Pension Benefit Guaranty Corporation, or the PBGC, against the assets of each member of the plan sponsor's controlled group

As a result of the more than 80% ownership interest in XO Parent by Mr Icahn's affiliates, XO Parent and its subsidiaries will be subject to the pension liabilities of any entities in which Mr Icahn has a direct or indirect

ownership interest of at least 80%, which includes ACF Industries, Inc , which is the sponsor of certain pension plans As most recently determined by the ACF plans' actuaries, pension plans maintained by ACF are underfunded in the aggregate by approximately $14 million on an ongoing actuarial basis and by approximately $102 million if those plans were terminated As a member of the same controlled group, XO Parent and each of its subsidiaries would be liable for any failure of ACF to make ongoing pension contributions or to pay the unfunded liabilities upon a termination of the ACF pension plans

The current underfunded status of the ACF pension plans requires ACF to notify the PBGC if XO Parent or its subsidiaries cease to be a member of the ACF controlled group In addition, so long as we remain a member of the ACF controlled group, certain other "reportable events," including certain extraordinary dividends and stock redemptions, must be reported to the PBGC

Because our New Common Stock is not listed for quotation on either the Nasdaq National or Small Cap Market, we are not subject to certain reporting and cor porate governance provisions.

The New Common Stock is not quoted on the Nasdaq National or SmallCap Markets Companies whose shares are quoted on the Nasdaq National Market and the Nasdaq SmallCap Market are required to comply with the Nasdaq Marketplace Rules, which, as required by the Sarbanes-Oxley Act of 2002, contain or will contain corporate governance requirements in addition to those contemplated by the Delaware General Corporation Law and the federal securities laws, including requirements related to

- Distribution of interim reports
- Solicitation of proxies
- Independent directors
- Audit committees
- Shareholder approval
- Stockholder voting rights
- Auditor peer review

As our New Common Stock is not so quoted, we are not subject to these requirements As a result, for example, we are not required to comply with recently adopted rules that will require listed companies to have increased *independent director representation on their boards of directors or an audit committee composed* solely of independent directors We currently do not intend to seek a listing on any exchange or the Nasdaq National Market or the Nasdaq SmallCap Market

Limited liquidity of our New Common Stock may result in delays in your ability to sell your common stock or lower your returns; you should be prepared to hold your investment indefinitely.

Although, there currently is a limited trading market for our New Common Stock on the Nasdaq Over-the-Counter Bulletin Board, known as the OTCBB, we cannot assure that an active trading market fo r our stock will continue Unlike the Nasdaq National Market and Small Cap Market where the issuer applies for listing of its securities, an active and orderly trading market on the OTCBB depends on the existence, and individual decisions, of willing buyers and sellers at any given time We will not have any control over the willingness of any such parties to create a trading market If the OTCBB trading market does not continue or becomes more sporadic, the market value of our New Common Stock could be affected adversely and it would become difficult to buy or sell shares on short notice Consequently, you should be prepared to hold your New Common Stock indefinitely

As of March 1, 2003, shares of New Common Stock were trading at less than $5 00 per share on the OTCBB, which could result in such stock being defined as a "penny stock" pursuant to applicable SEC regulations Accordingly, the New Common Stock may be subject to penny stock rules, which could adversely affect the market liquidity of our New Common Stock These rules impose additional sales practice requirements on broker-dealers that sell low-priced securities to persons other than established customers and institutional accredited investors and require the delivery of a disclosure schedule expla ining the nature and risks of the penny stock market As a result, the ability or willingness of broker-dealers to sell or make a market in our New Common Stock might decline

Future sales of our New Common Stock could adversely affect its price and/or our ability to raise capital.

Future sales of substantial amounts of New Common Stock, or the perception that such sales could occur, could adversely affect the prevailing market price of the New Common Stock and our ability to raise capital

As of March 1, 2003, there were approximately 95 0 million shares of New Common Stock outstanding The shares of New Common Stock owned by Cardiff, an entity owned and controlled by Mr Icahn, are restricted shares that may be sold only under a registration statement or an exemption from federal securities registration requirements Although Cardiff holds restricted stock, it may cause us to register sales of that stock at any time, whether pursuant to its contractual registration rights or otherwise

Pursuant to our Plan of Reorganization, we have issued three series of warrants to purchase up to an aggregate of approximately 9 5 million, 7 1 million and 7 1 million additional shares of New Common Stock, at exercise prices of $6 25, $7 50 and $10 00 per share, respectively The warrants will expire on January 16, 2010 In addition, if the eligible participants exercise all the rights in the Rights Offering, up to an additional approximately 43 3 million shares of New Common Stock will be issued to such eligible holders

We have options outstanding to purchase approximately 11 5 million shares of New Common Stock outstanding under our stock incentive plan as of March 1, 2003, with an exercise price of $5 00 per share Unless surrendered or cancelled earlier under the terms of the stock incentive plan, those options will expire in 2013 In addition, our stock incentive plan authorizes future grants of options to purchase New Common Stock, or awards of restricted New Common Stock, with respect to an additional 6 1 million shares of New Common Stock in the aggregate

Other Risks

Our adoption of "fresh start" accounting makes comparisons of our financial position and results of operations with those of prior periods more difficult.

Due to our emergence from bankruptcy pursuant to the Plan of Reorganization, we will implement "fresh start" accounting for periods following the restructuring Fresh start accounting requires us to restate all our assets and liabilities to reflect their respective fair values As a result, the consolidated financial statements for periods after our emergence from bankruptcy will not be comparable to our consolidated financial statements for the periods prior to our emergence from bankruptcy, which were prepared on an historical basis The application of "fresh start" accounting may make it more difficult to compare our post-emergence operations and results to those in pre-emergence periods

There may be risks related to our use of Arthur Andersen as our independent auditors for the year ended December 31, 2001 and prior periods.

Arthur Andersen, LLP, our former independent public accountants, which audited our financial statements for the years ended December 31, 2001 and 2000, was found guilty on June 15, 2002 of federal obstruction of justice charges in connection with the federal government's investigation of Enron Corp Arthur Andersen ceased practicing before the SEC effective August 31, 2002 Based on our understanding of Arthur Andersen's financial condition, it may be unable to satisfy any claims that arise out of its provision of auditing and other services to us, including claims that may arise out of Arthur Andersen's audits of our consolidated financial statements in years prior to 2002 The SEC has said that it will continue to accept financial statements audited or reviewed by Arthur Andersen in compliance with applicable rules and orders issued by the SEC in March 2002 in connection therewith

When we seek to access the capital markets in an offering that requires registration of securities under the Securities Act of 1933, as will be the case in the Rights Offering, current SEC rules require that three years of audited financial statements be included or incorporated by reference into the related prospectus These rules would require that we present financial statements for one or more fiscal years that were audited by Arthur Andersen, until our audited financial statements for the year ending December 31, 2004 become available The SEC recently adopted rules that exempt certain issuers that file registration statements under the Securities Act that contain financial statements audited by Arthur Andersen from having to comply with regulations that require such issuers to present manually signed accountants' reports and written consents of Arthur Andersen to include such financial statements in the registration statement If the SEC ceases accepting financial statements audited by Arthur Andersen without such reports and consents, we could be precluded from filing such a registration statement, unless our current independent auditors, Ernst & Young LLP, or another independent accounting firm, audits the financial statements for the years ended December 31, 2001 and 2000, which originally were audited by Arthur Andersen The time to complete such an audit would delay, and could prevent, us from accessing the capital markets

Forward-Looking Statements

Our forward-looking statements are subject to a variety of factors that could cause actual results to differ significantly from current beliefs.

Some statements and information contained in this Annual Report on Form 10-K are not historical facts, but are "forward-looking statements," as such term is defined in the Private Securities Litigation Reform Act of 1995 These forward-looking statements can be identified by the use of forward-looking terminology such as "believes," "expects," "plans," "may," "will," "would," "could," "should," or "anticipates" or the negative of these words or other variations of these words or other comparable words, or by discussions of strategy that involve risks and uncertainties Such forward-looking statements include, but are not limited to, statements regarding

- our services, including the development and deployment of data products and services based on IP, Ethernet and other technologies and strategies to expand our targeted customer base and broaden our sales channels,
- the operation of our network, including with respect to the development of IP protocols,
- liquidity and financial resources, including anticipated capital expenditures, funding of capital expenditures and anticipated levels of indebtedness, and
- trends related to and expectations regarding the results of operations in future periods, including but not limited to those statements set forth in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations below

All such forward-looking statements are qualified by the inherent risks and uncertainties surrounding expectations generally, and also may materially differ from our actual experience involving any one or more of these matters and subject areas The operation and results of our business also may be subject to the effect of other risks and uncertainties, in addition to the relevant qualifying factors identified in the above "Risk Factors" section and elsewhere in this annual report and in the documents incorporated by reference in this annual report, including, but not limited to

- general economic conditions in the geographic areas that we are targeting for communications services,
- the ability to achieve and maintain market penetration and average per customer revenue levels sufficient to provide financial viability to our business,
- the quality and price of similar or comparable communications services offered or to be offered by our current or future competitors, and
- future telecommunications-related legislation or regulatory actions

Item 2. Properties

We own or lease, in our operating territories, telephone property which includes fiber optic backbone and distribution network facilities, point-to-point distribution capacity, central office switching equipment; connecting lines between customers' premises and the central offices, and customer premise equipment Our central office switching equipment includes electronic switches and peripheral equipment

The fiber optic backbone and distribution network and connecting lines include aerial and underground cable, conduit, and poles and wires These facilities are located on public streets and highways or on privately-owned land We have permission to use these lands pursuant to consent or lease, permit, easement, or other agreements

We, and our subsidiaries, lease facilities for our and their administrative and sales offices, central switching offices, network nodes and warehouse space The various leases expire in years ranging from 2003 to 2021 Most have renewal options

Our headquarters are located in Reston, Virginia, where we are currently leasing approximately 170,000 square feet of space In February 2003, Dixon Properties, LLC, which is owned and controlled by Mr. Carl Icahn, acquired ownership of the building in which our headquarters is located in a transaction that was approved by the Bankruptcy Court in our Chapter 11 proceedings

Item 3. Legal Proceedings

We currently are not a party to any legal proceedings, other than regulatory and other proceedings that are in the normal course of business

As discussed above, on June 17, 2002, XO Parent filed for protection under the Bankruptcy Code Although XO Parent consummated its Plan of Reorganization and emerged from its Chapter 11 reorganization proceedings on January 16, 2003, disputes with respect to the amount of allowed claims owed by XO Parent to certain of its general unsecured creditors remain outstanding We expect these disputes to be resolved in the near term A resolution adverse to XO Parent of any or all of these claims would not result in a change in the distributions under XO Parent's Plan of Reorganization to any of the classes of holders of claims and interests summarized in Item 1, Business under the caption "Our Chapter 11 Reorganization–Distributions Under the Plan of Reorganization"

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the quarter ended December 31, 2002

PART II

Item 5. Market for Registrants' Common Stock and Related Stockholder Matters

Market Information

Our pre-petition class A common stock was traded on the Nasdaq National Market under the symbol "XOXO" until December 2001, at which time we voluntarily delisted it from that market On December 17, 2001, our pre-petition class A common stock began trading on the Nasdaq Over-the-Counter Bulletin Board until January 16, 2003, the effective date of our Plan of Reorganization, at which time trading was halted on the Nasdaq Over-the-Counter Bulletin Board

The following table shows, for the periods indicated, the high and low closing bid prices for our pre-petition class A common stock as reported by the Nasdaq National Market or Nasdaq Over-the-Counter Bulletin Board, as applicable

	2002		2001	
	High	Low	High	Low
First Quarter	$0 19	$0 04	$27 81	$6 25
Second Quarter	$0 07	$0 02	$ 5 22	$1 63
Third Quarter	$0 08	$0 02	$ 1 97	$0 33
Fourth Quarter	$0 15	$0 02	$ 1 72	$0 08

All interests in our pre-petition class A common stock were cancelled effective as of January 16, 2003, pursuant to our Plan of Reorganization

Our New Common Stock trades on the Nasdaq Over-the-Counter Bulletin Board under the symbol "XOCM" It began trading shortly after the first distribution of New Common Stock pursuant to our Plan of Reorganization

As of March 1, 2003, the approximate number of stockholders of record of our common stock was ten

Use of Proceeds

The initial public offering, or IPO, of our Class A common stock closed in October 1997, pursuant to a registration statement on Form S-1 filed with the Securities and Exchange Commission (File No 333-32001) that became effective on September 26, 1997 The net proceeds we received from the offering totaled approximately $226 8 million As of December 31, 2002, proceeds from the IPO remain available for future capital expenditures, operating expenses and other general corporate purposes

Dividends

We never declared or paid a cash dividend on our pre-petition class A common stock and have not declared or paid a dividend on our New Common Stock Covenants in the New Credit Agreement restrict our ability to pay cash dividends on our capital stock

Item 6. Selected Financial Data

Because the Plan of Reorganization was not consummated and effective until January 16, 2003, the selected financial data below as of and for the year ended December 31, 2002 does not include the effects of "fresh start" accounting provisions of SOP 90-7 Under SOP 90-7, the implementation of fresh start reporting is triggered in part by the emergence of XO Parent from its Chapter 11 proceedings Although the effective date of the Plan of Reorganization was January 16, 2003, we plan to account for the consummation of the Plan of Reorganization as if it had occurred on January 1, 2003 and implement fresh start reporting as of that date

The fresh start accounting provisions will require that we establish a "fair value" basis for the carrying value of the assets and liabilities for reorganized XO, the implementation of which will result in a substantial reduction in the carrying value of our long-lived assets, including property and equipment, fixed wireless licenses, other intangible assets and other noncurrent assets As discussed in note 3 to our audited consolidated financial statements set forth in Item 8 below, the Consolidated Balance Sheets to such financial statements include pro forma information as if the fresh start accounting provisions of SOP 90-7 had been implemented as of December 31, 2002

	Year Ended December 31,				
(Dollars in thousands, except share data)	2002 (a)	2001	2000 (b)	1999	1998
Statement of Operations Data:					
Revenue	$ 1,259,853	$ 1,258,567	$ 723,826	$ 274,324	$ 139,667
Loss from operations (c)	(1,208,898)	(1,949,891)	(1,011,652)	(366,530)	(206 184)
Net loss (d)	(3,386,818)	(2,086,125)	(1,101,299)	(558,692)	(278,340)
Net loss applicable to common shares (e)	(3,350,362)	(1,838,917)	(1,247,655)	(627,881)	(337,113)
Net loss per common share, basic and diluted (f)	(7 58)	(4 55)	(3 87)	(2 51)	(1 57)
Stateme nt of Cash Flow Data:					
Net cash provided by (used in) operating activities	$ 17,602	$ (560,877)	$ (559,414)	$ (349,192)	$ (174,484)
Net cash provided by (used in) investing activities	57,582	(708,598)	(1,464,495)	(1,050,344)	(1,276,747)
Net cash (used in) provided by financing activities	(6,079)	1,019,647	1,648,663	1,948,503	1,381,653
Balance Sheet Data:					
Cash cash equivalents and marketable securities	$ 560,983	$ 755,167	$ 1,860,963	$1,881,764	$ 1,478,062
Property and equipment, net	2,780,589	3,742,577	2,794,105	1,180,021	594,408
Investment in fixed wireless licenses, net	911,832	947,545	997,333	926,389	67,352
Total assets (d)	4,585,496	7,930,465	9,085,375	4,597,108	2,483,106
Total long-term debt (a)	5,165,718	5,109,503	4,396,596	3,733,342	2,013,192
Redeemable preferred stock, net of issuance costs (e)	1,708 316	1,781,990	2,097,016	612,352	556,168
Total stockholders' equity (deficit)	(3,032,282)	297,416	1,838,401	(13,122)	(246,463)

a On June 17, 2002, XO Parent filed for protection under Chapter 11 of the United States Code On November 15, 2002, the Bankruptcy Court confirmed XO Parent's Plan of Reorganization, and, on January 16, 2003, XO Parent consummated the Plan of Reorganization As of December 31, 2002, our long term debt was classified as current liabilities subject to compromise and our redeemable preferred stock was classified as redeemable preferred stock subject to compromise in the accompanying consolidated balance sheet As of December 31, 2001, as a result of our proposed reorganization, our long-term debt was in default Accordingly, our long term debt was then classified as a current liability at December 31, 2001 in the accompanying consolidated balance sheet See further discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations

b The selected financial data includes the accounts and activities of Concentric Network Corporation since June 16, 2000, the date that we merged with Concentric

c In 2002, loss from operations includes a non-cash asset write down totaling $477 3 million resulting from an agreement with Level 3 to return previously acquired inter-city fiber in exchange for reduced maintenance expenses beginning in 2003 In 2001, loss from operations includes restructuring charges totaling $509 2 million associated with plans to restructure certain aspects of our business operations In 2000, loss from operations includes a $36 2 million charge in connection with the June 2000 acquisition of Concentric resulting from the allocation of the purchase price to in-process research and development Loss from operations in 1999 includes restructuring charges totaling $30 9 million associated with relocating our Bellevue, Washington headquarters to Northern Virginia

d. In 2002, net loss and total assets reflects a $1,876 6 million impairment charge to write-off all of our goodwill as a cumulative effect of accounting change, pursuant to Statement of Financial Accounting Standards No 142, "Goodwill and Other Intangible Assets" or SFAS No 142 During 2002 we ceased accruing interest and penalties on our pre-bankruptcy senior unsecured notes, subordinated notes and Pre-Petition Credit Facility as of the Petition Date, in accordance with SOP 90-7 "Financial Reporting by Entities in Reorganization under the Bankruptcy Code", or SOP 90-7 We also ceased accruing dividends and accreting the redemption obligation on all of our outstanding preferred stock as of the Petition Date, in accordance with SOP 90-7 In 2001, net loss includes an extraordinary gain of $345 0 million resulting from the repurchase of certain of our senior notes and a write-down of $89 0 million for an other than temporary decline in the value of certain investments In 2000, net loss includes a $57 7 million write-down for an other than temporary decline in the value of certain investments and a $225 1 million net gain from the sale of an equity investment

e. In 2002, net loss applicable to common shares includes a net gain of $78 7 million as our preferred stock was deemed subject to compromise under SOP 90-7 as of the date XO Parent filed for bankruptcy protection, requiring us to recognize the remaining unamortized balance of our deferred modification fee and write off our unamortized discounts and issuance costs In 2001, net loss applicable to common shares includes a gain of $376 9 million resulting from the repurchase of certain of our preferred stock

f. The net loss per share data above has been calculated based on the shares outstanding of our class A and class B common stock prior to the consummation of our Plan of Reorganization Effective January 16, 2003, the effective date of the Plan of Reorganization, all interests in our class A and class B common stock were terminated and all outstanding shares were cancelled For further discussion of our Plan of Reorganization, see Item 1 "Business – Our Chapter 11 Reorganization" The net loss per share data above has been adjusted for the splits of our class A and class B common stock effected in 2000 and in prior periods

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking and Cautionary Statements

Some of the statements contained in this filing discuss future expectations and business strategies or include other "forward-looking" information Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements, including those factors set forth in Item 1, "Business – Risk Factors" The forward-looking information is based on various factors and was derived using numerous assumptions We undertake no obligation to publicly update or revise any forward-looking statements

Overview of Our Business

We provide a comprehensive array of voice and data communications services to business customers Our voice services include local and long distance services, both bundled and stand-alone, other voice-related services such as conferencing, domestic and international toll free services and voicemail, and transactions processing services for prepaid calling cards Our data services include Internet access, private data networking, including dedicated transmission capacity on our networks, virtual private network services and Ethernet services, and hosting services We also combine many of these services in flat rate service packages These services are offered to a variety of customers, including small, medium and large retail businesses, multi-location businesses, and carrier or wholesale customers

To serve our customers' broad and expanding telecommunications needs, we operate a network comprised of a series of rings of fiber optic cables located in the central business districts of numerous metropolitan areas, which we refer to as metro fiber networks, that are connected primarily by a network of numerous dedicated wavelengths of transmission capacity on fiber optic cables, which we refer to as an intercity network By integrating these networks with advanced communications technologies, we are able to provide a comprehensive array of communications services primarily or entirely over a network that we own or control, from the initiation of the voice or data transmission to the point of termination, which we refer to as end-to-end service This capability enables us to provide communication services between customers connected to our network and among customers with multiple locations primarily or entirely over our network

To develop these networks, we have assembled a collection of metro and inter-city network assets in the United States, substantially all of which we own or control, making us a facilities-based carrier These network assets incorporate state-of-the-art fiber optic cable, dedicated wavelengths of transmission capacity on fiber optic networks and transmission equipment capable of carrying high volumes of data, voice, video and Internet traffic We operate 37 metro fiber networks in 22 states and the District of Columbia, including 25 of the 30 largest metropolitan areas in the U S We have constructed or acquired many of these metro fiber networks, which consist of up to 432 strands of fiber optic cable and, in some cases, additional empty conduits through which fiber optic cable can be deployed For our inter-city network, we have acquired dedicated, high-capacity wavelengths of transmission capacity on fiber optic cables, onto which we have deployed our own switching, routing and optical equipment, which gives us greater control over how voice and data information is transmitted We also hold indefeasible exclusive rights to use

18 unlit fiber optic strands on the routes served by our intercity networks pursuant to arrangements with Level 3 Communications, Inc

Our Chapter 11 Reorganization

The Reorganization Proceedings

On June 17, 2002, XO Parent filed for protection under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York On November 15, 2002, the Bankruptcy Court confirmed XO Parent's plan of reorganization, and, on January 16, 2003, XO Parent consummated the plan of reorganization and it emerged from its Chapter 11 reorganization proceedings with a significantly restructured balance sheet

During the period immediately preceding and after the filing of XO Parent's Chapter 11 petition, we met with a committee of lenders under the Pre-Petition Credit Facility, an informal committee of unsecured creditors that represented holders of our senior unsecured notes (and following the filing of the Chapter 11 petition, the official committee of unsecured creditors appointed in the Chapter 11 proceedings) and potential investors to discuss potential restructuring transactions that could be implemented to reorganize our capital structure These discussions led to an agreement with the lenders under the Pre-Petition Credit Facility regarding the terms of a plan of reorganization that envisioned two potential reorganization structures the first of which was based on, among other things, a proposed cash investment in XO Parent by third parties (which was ultimately abandoned) and the second of which contemplated a stand alone restructuring with no new cash infusion The plan of reorganization, as supplemented, was filed with the Bankruptcy Court on July 22, 2002 and distributed to creditors of XO Parent eligible to vote in the reorganization

On August 21, 2002, High River Limited Partnership, a limited partnership controlled by Mr Carl Icahn, commenced an offer to purchase loans under our $1 0 billion secured Pre-Petition Credit Facility at a purchase price of $0 50 for each $1 00 in principal amount thereof Purchases made under this offer, together with the loans under the Pre-Petition Credit Facility that High River previously had acquired, resulted in High River holding approximately 85% of the loans outstanding under the Pre-Petition Credit Facility

On November 15, 2002, the Bankruptcy Court confirmed the Plan of Reorganization On January 16, 2003, XO Parent consummated the Plan of Reorganization and it emerged from the Chapter 11 reorganization proceedings The consummation of the Plan of Reorganization resulted in the following changes in our debt and equity capital structure

- $1 0 billion of loans under the Pre-Petition Credit Facility were converted into $500 0 million of outstanding principal amount under a New Credit Agreement,
- The extinguishment of all amounts due under our pre-petition unsecured senior and subordinated notes and certain general unsecured obligations, and
- The cancellation of all outstanding shares and interest in our pre-petition preferred stock and pre-petition class A and class B common stock

Under our Plan of Reorganization, the following equity securities have been or will be distributed to holders of the Pre-Petition Credit Facility and holders of XO Parent's pre-bankruptcy unsecured senior and subordinated notes and pre-bankruptcy general unsecured claims

- 95 0 million shares of New Common Stock,
- Series A Warrants to purchase 9 5 million shares of New Common Stock at an exercise price of $6 25 per share,
- Series B Warrants to purchase approximately 7 1 million shares of New Common Stock at an exercise price of $7 50 per share, and
- Series C Warrants to purchase approximately 7 1 million shares of New Common Stock at an exercise price of $10 00 per share

Under the Plan of Reorganization and after the SEC has declared effective our registration statement, XO Parent will issue to certain holders of claims and interests in XO Parent who held such claims and/or interests as of the November 15, 2002 record date, rights to subscribe for up to 40,000,000 shares of New Common Stock, at $5 00 per